Challenge

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from the editor

a personal note

THE STATE of Michigan has been very much in the news lately, but this editor's interest is more piqued for the moment by the people leaving Michigan than by the problems of those who are staying. For example, there are the so-called Fifty-niners, a small group of modern-day homesteaders who decided to leave recession-hit Detroit and trekked northward to seek a new life in Alaska. It is to be hoped that their humble wishes for a slightly better life and livelihood will be fulfilled.

There is also the saga of Stanley Yankus, who has also decided to leave Michigan. But this man and his family are bent on going all the way –clear out of the U.S. and into Australia. Unlike the Fifty-niners, however, the Yankus family was not being crushed by the weight of factory unemployment. In point of fact, Stanley Yankus was a Michigan farmer who decided that farming in the U.S. had become an impossible form of livelihood. And apparently he feels that even a state as far away as Alaska is not far enough to restore confidence in his future in this country of his birth.

Now, here are two cases of people, caught in what they consider to be impossible situations, taking unusual measures in an attempt to regain mastery over their own fates. One cannot help but ponder, sympathetically, over their chances.

It is interesting that the Fifty-niners, having tasted the bitterness of prolonged rejection by industrial society, should now return to the traditional labors of their forebears. Their choice violates the trend of the past 40 years. Since 1920, agricultural employment has suffered a net loss of 7.3 million people. The family-owned farm, that American symbol of virtue, hard work, self-made success and bucolic bliss, has become an increasingly unpalatable form of livelihood; so much so that almost one million people each year leave the farms–and this in spite of very substantial subsidization and paternalism by the federal government. But still the American fiction lingers on –that if a man owns his own land, his labors will be honestly rewarded. Missing from this script is the hard fact that if an honest man, seeking to live by the sweat of his brow, does not have the $25,000 necessary to run an average modern farm today, he will not get on at all; and if he does, the only way he can survive from the deep freeze of declining prices is to take up permanent lodgings in the hothouse of government regulation.

Stanley Yankus, the Michigan farmer, is fed up with government regulations. He raised more wheat than the government quota allowed him, feeding the excess to his 5,000 chickens. For this offense he was fined $4,500. The absurdity of not being able to feed his own wheat to his own chickens was more than Yankus could stand. So, he is off for Australia, where he intends to farm in a freer atmosphere (which is not as free as he thinks).

Still to be resolved in the U.S. is the issue of whether farming is a way of life or a form of enterprise. Realism points to the latter. Sentiment votes for the former.–H.B.

letters TO THE EDITOR

Challenge invites your comments. Address letters to CHALLENGE, *475 Fifth Avenue, New York 17, N. Y.*

Taxes and investments

• Your contributing author, Prof. C. Lowell Harriss, has written a most interesting article in your March issue on "Taxes and Investments." He has failed, however, to present evidence in behalf of some of his alleged conclusions in which the largely unsubstantiated assertion is made as follows: "Also needed is an increase in the effective rates on what is now undertaxed: municipal bond interest, capital gains, depletion in excess of cost, etc."

As regards municipal bond interest, it would perhaps seem reasonable that tax immunity be granted to obligations issued for nonrevenue producing purposes such as hospitals and schools. It might well be denied to revenue bonds issued for toll highways, socialist power projects and the like.

When it comes to capital gains taxes, however, there is no excuse for taxing as income increases in dollar value of capital assets which have occurred almost entirely from currency debasement. There is every reason in the world to eliminate this tax completely. No other civilized nation dares impose such a venture-stifling impost. After all, this tax is levied on those who actually *sell* such assets. No penalty is imposed if such assets are *retained.* The result is to sterilize billions of job-creating risk capital which, if put to work in new businesses, would undoubtedly *increase* the over-all federal tax hike.

I wish you would ask your readers what *they* think.

WILLIAM JACKMAN
Investors League, Inc.
New York, N. Y.

An income tax is one device which can differentiate among people on rational bases–notably differences in income. In trying to do so, our law has imposed rates which, I believe, are too high. One means to reduce rates is to increase the tax base. This can be done by making differentiations more, rather than less, rational.

Exemption of municipal bond interest offers an advantage to states and localities which is substantially less than the cost to the Treasury. The difference is a graduated benefit to persons in upper income groups. It is a highly inefficient way of achieving an objective. Capital gains and losses, to the extent feasible, should be included in the tax base on an equal basis with other changes in economic power as meas-

ured in money. As any tax expert knows, by no means do all capital gains reflect only the changing value of money. I agree that allowance throughout the tax system for inflation would have merit, but special treatment for those effects which take the form of capital gains does not meet the problem. Let's face it–any efficient solution of the many problems presented by capital gains and losses must involve some form of income averaging.

CHALLENGE *readers will undoubtedly "vote" for retention of existing special provisions when the issue is presented as in Mr. Jackman's letter. The alternative I posed, however, was rates versus base. I vote for lower rates and a broader base–C. L. Harriss*

[*For a more complete statement by Prof. Harriss, see W. J. Shultz and C. L. Harriss, "American Public Finance," 7th edition, published in April, 1959.–Ed.*]

Controversy in education

• We enjoy using CHALLENGE with our high school seniors in introductory economics. It provides excellent source material, and they find it very readable and useful for research purposes. Would it be possible to provide more pro and con discussions of controversial issues in economics as was done on "right-to-work" laws several years ago?

WILLIAM E. DUNWIDDIE
Neenah High School
Neenah, Wis.

Long view

• Some time ago we began worrying about Germany. Some time later we woke up to the danger of Russia. Now we are getting concerned about China. I suggest we skip China, while we still have a chance, and begin looking for the country after that to be apprehensive about.

JOSEPH CLANCY
Newark, N. J.

Not of the flock

• I thank the good union shepherds (*Challenge Interview*, March, 1959) for their efforts to bring us into the fold but I prefer the grass I can glean for myself to an extra ration of baled hay in the form of fringe benefits.

SARAH MORETTI
Union City, N. J.

Frontiersman

• Your *Permanent Frontier* Series is doing a good job of refreshing my memory of American economic history. Have you thought of publishing the series in book form?

J. H. GLAZER
Santa Monica, Calif.

Left to right

• I will admit that your book reviews are impartially unkind. In March, for instance, you are hard on a conservative apologia for Hoover, a socialist attempt to understand the Soviet Union and two New Deal claims to interpret history. I am one of those naive persons who wants something firm to believe in, and you are making it very difficult for me. Why can't we make up our minds on some, at least, of the major events of history? I don't know why we can't, but I know that we shan't.

ROBERT N. SCOTT
Miami, Fla.

Challenge Notes

Fixing the rules; economic Cassandras and the future; lie detectors in industry; in a jiffy

■ A "SOLUTION" to the inflation problem that is finding increasing favor among economists is the creation of a tripartite board, composed of representatives from labor unions, business organizations and the "public," whose job it would be to advise the Federal Reserve Board on how to achieve maximum stability and growth. Spokesmen for labor and business groups, as well as such academic economists as Prof. John K. Galbraith, author of the best seller, *The Affluent Society,* have come out in favor of such a board.

Proponents of the idea believe that a public forum in which groups responsible for inflation would have to justify themselves and suggest concrete ways of coping with the consequences of their acts would lead to more "self-restraint" in corporate and labor policies. Considering that inflation is unpopular with the vast majority of Americans who actively resist price increases (see *Challenge Interview,* pages 36-41), there is a good deal to be said for any move which focuses public attention on the problem. That is what Congressional committees and a free press are for.

On the other hand, *directly* involving pressure groups in monetary policy is a sure way of increasing rather than diminishing inflationary pressures. It is true that the Fed's independence from the Treasury does not exempt it from other special pressures. Decisions on discount rates and reserve requirements are not made in a political vacuum.

The problem is to decide what *kind* of political pressure should be exerted on monetary policy. It may well be that the Fed is too much dominated by the "bankers' point of view" which places a premium on "soundness" and "stability," often at the expense of growth. But is this altogether a bad thing in a society where most other important groups have an opposite set of biases? Business and labor groups should certainly be given

every opportunity to state their case in the formulation of general economic policy. But they should not be allowed to fix the rules of the game so that they can escape the consequences of inflationary policies at the expense of the consumer.

Cry wolf

The temptation to cry "wolf" seems to be irresistible for commentators on economic matters–no matter what their ideology. During the depression, many businessmen predicted that disaster would follow the New Deal's deficit budgets. After the war, many economists predicted disaster if government did not finance our reconversion from war through deficits. In neither case did the predicted disaster materialize.

About 13 years ago, a distinguished Australian economist predicted that no private enterprise nation could survive if it taxed more than 25 per cent of its national income. In 1958, the U.S. tax take (federal, state and local) amounted to more than 30 per cent of national income. True, we had a recession in 1958, but our tax take has exceeded 25 per cent of national income even in prosperous years such as 1956.

The moral of the tale is not that we should ignore the warnings of experts or that experts should stop being Cassandras when they feel the facts warrant it. It does suggest, however, that the assumptions of the present do not provide us with any certain indication of the future.

Truth and consequences

The bigger an organization gets, the more anxious it seems to be to test prospective employees. Besides job performance, most large companies today test personality, attitudes and even beliefs.

Up to now, it has still been possible to protect both privacy and one's job by telling the tester what he wants to hear even if that means being less than truthful. But watch out. Today, seven out of 10 lie detector tests are being used for noncriminal purposes. According to a trade magazine, the tests are being used to "weed out the 'yes' men who act differently behind the chief executive's desk." If business organizations have no better way of weeding out "yes" men than personality tests and lie detectors, our free society is really in a bad way.

Quick as a flash

Next time the waitress says she'll serve you "in a jiffy," confront her with the following definition of jiffy used by the missile industry: "The time required for light (which travels at a speed of 186,000 miles per second) to travel one centimeter."–M.K.

by James William Morley

JAPAN'S 'BIG BROTHER'

China uses the lever of trade in an attempt to pry Japan loose from Western orientation

■ THE LURE OF the China trade, always a potent force in Sino-Japanese relations, is today exerting greater influence on Japan's policymakers than at any other time in Japan's postwar history. It is so great, in fact, that it seems at last to be persuading them to take the first step toward establishing official relations with the Communist regime on the mainland. On February 3, Japan's Premier Kishi told the Budget Committee of the U.S. House of Representatives that he would be willing to enter into a conference with the Chinese Communists on the ambassadorial level and even to consider negotiating an official governmental agreement.

This reversal of attitude comes at the very time that Japan is seeking to revise its security arrangements with the United States. As Mao Tse-tung claimed, the East wind does indeed blow stronger. Will it prevail? It is important that we try to understand the pressure our Japanese friends are under.

Since Japan recovered its independence in 1952, it has aligned itself firmly with the Western world. The price has been high. Cultural bonds of thousands of years have had to be loosened. The threat posed by a hostile continent to Japan's security has had to be endured. Before the war, trade with China was vital to Japan's welfare. China was Japan's most important market, taking nearly

one-fifth of its exports, and the most important supplier of certain essential raw materials, such as salt, iron ore, coal and soybeans.

It is true that the bulk of this prewar and wartime trade was with Manchuria and Kwantung, areas then under Japan's political control, so that we may question whether Japanese businessmen could today compete so effectively in those markets without the special privileges of the past. It is true also that they must in fact expect to labor under political discrimination. This has been the case since trade was resumed by unofficial agreement in 1952. In each of the informal trade pacts signed by official agencies in China and private bodies in Japan, the Chinese have insisted on the principle of barter and on the exchange of goods only within certain categories; they have refused to sell certain goods most desired by the Japanese, except in return for certain strategically important products which the Japanese government has been reluctant to sell. Three trade agreements, in 1952, 1953 and 1955, have resulted in disappointingly small exchanges.

Blame government

It might be supposed that this postwar experience would have convinced many Japanese that the vast trade promised by the Communist Chinese is not likely to develop and that economic and political conditions in China are largely to blame. But that is not the case. Most Japanese have rather been inclined to accept the Red Chinese explanations and blame the government of Japan.

The reason for the failure of the promised trade to materialize, say the Chinese Communists, is not the weakness of the mainland economy, but rather the "artificial obstacles" placed in the way of trade by Japan's conservative rulers. The "artificial obstacles" they cite have changed over the years. In the beginning the chief "obstacle" was said to be the embargo policy which the Japanese government pursued in accord with the United States and other democratic states as an outgrowth of the Korean war. Coupled with Peking's insistence on barter within categories, there can be no doubt that this policy was indeed seriously restrictive.

But as the embargo was gradually eased, new "obstacles" were found. Especially since 1955 the Chinese Communists have insisted that trade cannot develop naturally until an agreement is reached between the central banks of the two countries, until permanent trade missions are exchanged, and until both governments agree to "support and assist" the agreements. And when, in April of last year, the Japanese government

agreed to accept an exchange of permanent trade missions and to "support and assist" the newly negotiated fourth trade agreement, the Chinese Communists abruptly found new "obstacles." Trade could not be conducted, they said, unless Japan recognized the "right" of a permanent mainland trade delegation to fly its Communist flag in Japan and unless Japan agreed to moderate its nonrecognition policy. The fourth trade agreement was rejected.

When the Communist flag was torn down by a young Japanese at an art exhibit in Nagasaki on May 2, 1958, the Peking government angrily and abruptly broke off all contacts with Japan and launched an extremely bitter propaganda campaign against the Kishi government. No more cultural exchange, no more trade, no more relations of any kind, it told a Japanese Socialist party representative in Peking a few months later, unless and until the "three principles" and the "three conditions" are met. Red China wants an acceptable apology for the Nagasaki flag incident and an indication from the Japanese government that it is ready to abandon Taiwan and to recognize the regime in Peking. In short, no trade without political concessions.

This has always been the foremost objective in Peking's policy. It has consistently used the promise of trade to try to persuade Japan to renounce her Western ties and to gravitate into the neutralist and eventually the Communist orbit. The impressive fact is that they have succeeded so well in their campaign. By 1957, when the trade trickle was cut off, a number of Japanese businessmen, perhaps a majority of Japanese intellectuals, Socialist party leaders and even a number of conservatives had come to accept the contentions of the mainland Chinese that vast trade is possible. Through speeches, mass organizations and the ballot they talk nostalgically of the cultural ties with China, enthusiastically of the trade possibilities, and bitterly of the government's refusal to withdraw recognition from Taiwan and to cut itself adrift from the U.S. security pact.

Commercial thirst

Until February of this year, the Japanese government, headed by the Conservative party, has fairly consistently fought this campaign. It has stoutly insisted that it must honor its commitments to Taiwan, that it must rely for security on its military ties with the United States and that it must not modify its nonrecognition policy except in accord with developments in the U.N.

On the other hand, Japan is absolutely dependent on its foreign

trade, and the government can hardly deny that mainland trade, whether a trickle or a river, can at least partially slake Japan's commercial thirst. Nor can it ignore the ground swell of support in Japan for promoting that trade. As a result it has gradually made concessions. At first it agreed to reduce the embargo. Then it agreed to "support and assist" an unofficial government. Now it announces its readiness to negotiate an agreement itself–provided it is limited to trade. "Restoration of diplomatic relations," said Premier Kishi recently, "is not immediately possible."

Deep yearnings

Why is it that the Communist Chinese have been so successful? One reason is that the Japanese people have deep historical and psychological yearnings for the continent. They remember well the trade of the past. They cannot deny their cultural bonds. Many sympathize with Chinese resentments against the West. Many genuinely admire the Communists' recent organizational and productive achievements. Some feel guilty for Japanese treatment of China in the past. Most feel that they understand the Chinese better than anyone else does and that they can therefore work with them safely.

It is also true that the Japanese have so far been unable to satisfy their trade needs within the confines of the "free world." Japan has not yet been able to recover the share of world trade it enjoyed before the war. Nor has it been able to find export markets large enough to pay for more than about half of its import needs.

All of these factors have provided a resonant instrument on which the Chinese have played a siren song of "people's diplomacy." The Japanese government, cries Peking, is an agent of American imperialism, an enemy of the Japanese people, a threat to "the peace of Asia and the world." The Japanese people, on the other hand, are like the people of China: they "love peace, and hope for mutual friendship." They want only "independence, democracy, and peace."

Shortly after the Moscow Economic Conference in April 1952, Peking opened informal negotiations with unofficial "people's" groups in Japan leading to the repatriation of more than 226,000 Japanese from the mainland. China also permitted a number of former Japanese, defined as war criminals, to return home. Over the next six years it invited nearly 4,000 Japanese leaders from all fields–cultural, athletic, political, economic, even military–to tour the mainland and meet its leaders at Peking's expense.

Trade fairs have been opened. Friendship has been pledged. The talk of contracts has been warm and long. And when the banquets and receptions were over, the Japanese visitors have usually been persuaded in turn to proclaim their friendship, to call for expanded trade and cultural relations, and frequently to sign joint statements pledging themselves to work for closer ties and diplomatic relations with the Peking regime.

Powerful groups

All groups were cultivated, but particular attention has been given to Japanese businessmen, intellectuals and Socialists. The result has been the formation in Japan of several powerful businessmen's organizations to promote trade and diplomatic relations with mainland China; the formation of front groups, led by intellectuals, for the same purpose; the passage in the Diet of resolutions urging more trade; and the adoption by the Socialist party of foreign policy programs closely aligned with many of the ideas expressed in Peking. In April, 1957, for example, a Japanese Socialist party delegation, led by Secretary-General Asanuma, returned from talks with Peking leaders and called jointly with them for a restoration of diplomatic relations, a severing of the ties with Taiwan, the admission of Peking into the U.N., the abolition of all "antagonistic military blocs in Asia," and the conclusion of a nonaggression pact among mainland China, the USSR, Japan and the United States.

This is precisely the goal at which the "people's diplomacy" has been directed. As Chou En-lai once explained: "Starting from frequent nonofficial visits and agreements, relations can be advanced considerably between the two countries, finally leaving only the question of the diplomatic announcement of the ending of the state of war and the resumption of normal relations." Whether Peking hoped to accomplish this final result primarily by persuading the Japanese people to force the conservative government to change its mind, or whether it hoped to stimulate a popular movement which would carry the Socialist party into power, is not clear. In the spring of 1957, however, it seems to have decided on the latter. This is at least one plausible explanation why, just before the general election in April of that year, it broke off all trade and other contacts on the plea of the intransigence of the Conservative party in power. If that was its purpose, it failed, for the Japanese people interpreted this as an attempt to interfere in Japan's domestic affairs and penalized the Socialists accordingly.

But the advantage to the Conservatives was only momentary. Japanese expectations had been so highly raised that this sudden cutting off of the trade has seemed too much to endure. Once before, in 1956, a Conservative government expressed a willingness to talk to Peking's leaders, but powerful opposition within the government party forestalled any action. Today the pressure for talks and agreements is greater, and even the American-oriented wing is being forced to yield.

What does this mean to us in the United States? It means two things. First, it points up the fact that we have got to help the Japanese find a more fundamental solution to their trade problems. Since World War II, the United States has become Japan's most important trading partner, selling it about one-third of its foreign needs and buying from it about one-fifth of its exports. The result is a lucrative trade for both countries, but a highly unbalanced one, for the Japanese have consistently been able to sell to us goods valued at only about half as much as those they have been buying from us. The reason is largely the decline of the raw silk market here, the decline in earnings from shipping services, and discrimination against Japanese goods in the American market through tariffs and so-called gentlemen's agreements to limit sales. Only special procurement and other unusual American aids have enabled the Japanese to close the exchange gap and maintain at least a portion of the large volume of imports essential to their economy. The direct cost to American taxpayers has been more than $6 billion. This is hardly a situation that can continue indefinitely. A healthier Japanese-American trade relationship has got to be built.

Secondly, we must be prepared to recognize that the popular pressure in Japan for trade with the Chinese mainland is becoming irresistible and that it may well lead the Japanese government into at least *de facto* relations with the mainland government. This means in turn that the Japanese government's ability to maneuver between the two Cold War blocs may well be increased. We shall need to accord its views increased respect and adjust all our relations with it on a basis of true equality. Only then will long-run friendships and cooperation be possible. ■

Mountain Driving

IN THREE YEARS it will be possible to cross the French-Italian border via a tunnel through Mont Blanc. Three hundred cubic meters of fresh air per second will be pumped into the 7.4-mile tunnel to expel the fumes of the 3,000 cars expected to use it daily.

The nation's overspending on highways drains resources sorely needed elsewhere for a balanced program of growth

too many highways?

by William N. Leonard

■ In April 1956 President Eisenhower signed [illegible] misgivings" a bill launching a federal program aimed at speeding construction of $40 billion in toll-free superhighways. The measure authorized an increase in previously planned federal spending on the 41,000-mile interstate system of roads, and raised the federal government's share from one-half to two-thirds of highway construction costs, with the states bearing the remainder. Indeed, where states adopt controls over billboard advertising, the federal share rises to 90 per cent of the total.

The president's "misgivings" had to do with the departure from the long-established principle of equal sharing of highway expense between the federal government and the states, and a provision of the law which allows the federal government to advance money to the states to finance their one-third share of the cost. He yielded, however, to the job-making aspects of the legislation, estimated by its backers to put 88,000 additional persons to work in construction and related supply industries.

Although the antirecession character of the highway measure prompted its passage by a large majority in Congress, the new program represents the culmination of many years of effort by highway backers to get more and more funds from the federal government. The "good roads" movement of the 1920s–to take cars out of the mud and put them on asphalt and concrete–had graduated to the "superthruway" program of the 1950s.

Speaking of highway finance,

Bertram Tallamy, Federal Highway Administrator, noted that annual capital expenditures for highways by all units of government, representing additions to or improvement of the highway plant, rose from $5 billion in 1956 to $6.2 billion in 1958, and were expected to reach $8.1 billion in 1962. Year by year, this represents a continuous increase of 10 per cent in the amount of money spent on roadbuilding. Federal aid funds, which accounted for 29 per cent of capital expenditures on roads in 1958, are calculated to rise to 42 per cent during the 1960s as the interstate system of highways develops.

Willing to pay

The general success of the postwar turnpike boom financed through tolls had indicated that the public was willing to pay for wide, straight roads, with limited access and a minimum of traffic interference, which permitted cars and trucks to speed along at 60 to 70 miles per hour between major cities. The Pennsylvania, New Jersey, Maine, Florida and many other turnpikes had enjoyed such a rush of business that the tolls sufficed to amortize debt many years before obligations became due. Eyeing the turnpike boom, state officials began to issue bonds to finance thruways of their own, resulting in a debt before the end of 1958 of nearly $13 billion, divided almost equally between toll and toll-free facilities.

How is it possible that a $40-billion program can pass through Congress with such silent ease? First, everyone wants good roads for driving, since the car represents America more than the bald eagle, the bison or even the bathtub. The car has become the symbol of material success and social status, as well as an instrument of family pleasure.

While the population increased 22 per cent from 1945 to 1957, motor vehicle registrations went up 116 per cent to reach a total of 66.3 million. Furthermore, passenger cars and trucks are being made heavier and speedier than ever before, requiring wide, straight stretches. Superhighways have become an important adjunct of our fast-moving, fun-loving culture. The cause-and-effect chain continues: superhighways attract more supercars, which in turn justify construction of more miles of thruways.

In the second place, there is something in the highway program for everyone and for every section of the country. Indeed, the federal highway program represents the nation's largest pork-barrel, feeding not only car, truck and tire manufacturers, but highway engineering firms and contractors in every state, the oil in-

dustry, building material companies and the steel industry.

Third, an imposing array of private interest groups consolidated their efforts to push through roadbuilding programs. Testifying and lobbying for the highway bill were such organizations as Automobile Assn. of America, American Trucking Assn., National Assn. of Motor Bus Operators, Private Truck Council of America, Automobile Manufacturers Assn., American Roadbuilders Assn., Associated General Contractors of America, Rubber Manufacturers Assn., National Tire Dealers and Retreaders, Chamber of Commerce of the United States, American Farm Bureau Federation and National Grange.

To this list of powerful interest groups are added associations of state and local officials, including: American Municipal Assn., American Assn. of State Highway Officials, U.S. Conference of Mayors and National Assn. of County Officials.

Potent army

Without doubt, highway programs bring together the most potent army of pressure groups to be found backing any legislation. Only the Association of American Railroads raised a voice against the program, but its objection was not only anticipated but overwhelmed by a chorus of "Ayes." In the federal highway program there has developed a coincidence of general public interest and the pressure of articulate groups, with energy sufficient to generate a $40-billion program in which the federal government supplies 42 per cent of all funds.

By contrast, programs of aid to education appear both little and late. Although public need for more schools and colleges has received a burst of postsputnik publicity, although prominent spokesmen repeatedly call attention to the problem of educational finance, although the provision of adequate education is a state function in which localities and the federal government share, the drive for federal funds has fallen considerably short of the mark.

While communities groan under the imposition of steadily rising taxes on property, while states strain their resources to assist local school districts, federal aid remains at the lowly level of three cents of every dollar spent for public education. This situation endures, even though it is recognized that education has become, like good roads, not merely a matter of higher standards of welfare, but an important aspect of national security.

Unlike education, which is carried on in full view of the public, highway construction is handled at some distance from the public

by "experts." The latter are technically trained highway engineers, well versed in aspects of applied physical science, but not in social science. These practitioners draft plans for highways admirable in their sweep and grandeur, and technically precise and sound, but with little or no regard for public need, human ecology or the prudent allocation of resources.

Intercity in character

For some time it has been evident that our greatest motor vehicle transportation problems and our greatest need for traffic relief occur in metropolitan areas. The federal highway program, however, is intercity in character and offers no assistance whatever to urban transport. The new federal superhighways will parallel existing roads and turnpikes, diverting traffic from them and possibly placing in jeopardy the early amortization of some toll roads. As an illustration, the federal highway now under construction in New Jersey runs between U.S. Route 1 and the New Jersey Turnpike which parallel each other throughout most of the state.

The disregard of human economy in roadbuilding finds frequent expression in the rigid planning of engineers who, following land contours faithfully, have produced highways that ploughed through towns, sometimes splitting them in two. One senses that this might occur more frequently were it not so expensive to condemn built-up land. Usually municipal opposition to these blitzkreig tactics has proved unavailing, and the unhappy town has undergone painful surgery–for example, Nyack, N. Y. Local groups, acting not in blind opposition to the highway but proposing alternate routes, often find themselves lost in a labyrinth of red tape and highway bureaucracy and denounced as opponents of "progress."

Together with the power of eminent domain goes compensation for the taking of land and buildings. The highway "must go somewhere," and if it is pushed through a settled area, property owners will be paid for their pains. However, while private losses are matched by public funds, all economic costs are not met. The superhighway removes wide stretches of land from the tax rolls, and tax receipts of local governments are permanently reduced, shifting the burden for the support of local services to remaining property owners.

Uneconomic allocation

Viewed in its entirety, the program of constructing coast-to-coast superhighways represents an uneconomic allocation of resources. The concentration on in-

tercity rather than urban transport is one aspect. The impact of the spreading network of highways upon present rail facilities is another.

With growing force, the builders of the new highways will be adding to the woes of the intercity rail systems of the country which, although excessive in relation to need, manage to fulfill an essential function in the long haul of bulk freight and in intercity passenger service. In recognition of the still important role of the railroads in carrying passengers, the Department of Defense is currently stockpiling rail passenger cars as a precautionary measure in event of war.

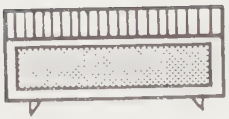
On the rampage

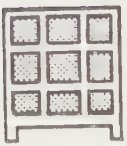
Does commercial highway transport pay its way? The evidence indicates that it does not. Engineering studies before and after World War II found that the passenger car operator is helping to support the heavy truck and bus through his payments. By contrast, as the Assn. of American Railroads repeatedly points out, the railroads meet their costs in full, and in addition pay taxes on their rights-of-way and other real property. Proudly independent of public subsidy, the iron horse seems destined sooner or later for a grave dug by the rampaging roadbuilders.

If anything, the funds spent for roads will increase in the years to come. This will result not so much from rising costs of construction as from additional funds coaxed from state treasuries by the terms of the federal program. The lure of federal aid, up to 90 per cent, will induce states to put up larger sums of money for roadbuilding. Already several states, including New York, have raised taxes on gasoline or introduced other levies in order to participate more fully in the federal bonanza.

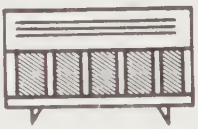
With the haste of states to obtain federal funds, and the resultant using up of the federal allocations, the superhighway lobby will then be justified in asking for greater federal appropriations for roads. Before the size of this expanding program, the California Gold Rush of 1849 will pale into insignificance. And the taxpayer, trapped by his own enthusiasm for progress, will pay more for roads, not merely to Uncle Sam but to his state government.

Those who raise questions about the size and propriety of the allocation of tax monies to the new intercity superhighways will no doubt be termed persons of small or slanted vision by the determined roadbuilders and their powerful allies. For in America all men of good will want good roads. But is it possible to get too much of a good thing? ■





PANIC ECONOMICS IN STEREO



A revolution in music recording has started a mad dash to keep up with technical changes

by Edward Tatnall Canby

■ CONVERTING TO STEREO? If you play records for any purpose other than background music, you'll be converting fairly soon if you haven't already. There's a boom on, and it's of a typically American sort.

Don't think that stereo is merely an excuse for double sales and double profits, plus planned obsolescence. It is the biggest force to hit the phonograph business since the long-playing record, and it involves the biggest gamble and the toughest sales push since records became a big business around 1900. But the gamble is based on numerous realities. Stereo decidedly has honest values for the listener, and its "spectrum" is wide. It can add to the potency of almost any kind of recorded sound, from the coarsest to the most refined, from jet planes and juke boxes to Beethoven.

The most serious trouble with stereo from the sales viewpoint is that it is subtle by nature. It must be amplified saleswise into the obvious appeal demanded by our unsubtle economic system. Most people, hearing good stereo for the first time, are disappointed. Often they cannot distinguish it from old-fashioned monophonic sound. The better the stereo, the gentler its effect, and the medium at its best requires understanding, education and generous listening time. It is difficult to make a hard sell for relaxed cultivation.

Stereo in itself is just so much noise–and so is any recorded or reproduced sound. This might seem obvious, but it has not proved so. We have made high fi-

delity into an end in itself, and stereo, too, is being violently promoted as a sound sensation. The plain fact is that like any recorded sound, it takes it values and meanings straight from the content of the sound, on every level. Stereo adds something to any noisy "hi-fi" recording, but it adds untold subtle values to fine music.

Here, I think, is the main clue to our present stereo insanity. I am outraged, daily, by the grotesque, preposterous claims made for stereo in our present advertising; I am shocked at the sleazy, haphazard quality of much of the equipment that goes with them. I am dismally certain that in most actual listening situations, people are *not hearing even a vestige of actual stereo effect.* I have seen and listened to too many "demonstrations."

Large numbers of the very sales people who promote stereo so loudly have not the faintest idea of what it is. Many of the most dedicated technicians in the development end of stereo are themselves tone deaf to the esthetic effects of their work. They are limited to technical sound analysis, necessary enough but not indicative of musical quality.

We are in the midst of a mass-appeal boom for a product that is quietly legitimate, but which is being distorted into meaninglessness in the process of being designed, distributed, publicized and sold. A mess. But a rather typically American mess, and one that is not as bad as it may seem to those who are sensitive to the real, not the publicized values in sound.

Stereo will survive because it is a good thing. In our mad way, we must always launch our new ideas in this fashion. If I did not believe this, my faith in our peculiarly American way of life, advancing crabwise, the worst foot foremost or sidewise, would be sadly shaken! I feel a certain affection for the soggy mess we make of almost anything good–and the sure-footed way by which we wade through to the solid values, while cleaning off the silliness.

We get things done by an approach that is practically never wise, deliberate, considered or conservative. Those fine adjectives describe Europe's well-developed and literate view of things like stereo or the long-playing record. Europe takes its time, moves slowly, carefully, sensibly. But we get there faster.

Thus the British had the minds that foresaw the stereo disc, and they accomplished a major part of the theoretical development–before the war. But it was the American boom that started it rolling, and forced literally thousands of cautious, timorous, close-to-the-chest manufacturers, here and abroad, to put extraordinary

emergency effort in a development that might have taken years. I think it would never have occurred at all, were it not for that all-out American explosion, the peculiar mixture of exuberance and sheer panic that gets us suddenly going, top-speed, on a new project.

Profound bearishness

I was behind the scenes long before the boom broke into the open. The present enthusiasm was preceded by the most profound bearishness. The entire audio or hi-fi industry trembled at the thought of stereo. You could not find one professional in a thousand who would predict anything but the most dismal future, if somebody–somebody else–should start making trouble. The pessimism was so extreme that it accurately augured the present reversal, the tremendous surge of near-panic energy that has gone into putting the new product over. Everybody knew the storm was coming, but nobody wanted to admit it.

The big stereo break came, typically, via a single, premature stereo disc that was mailed as a test sample to manufacturers in December, 1957. It was the brash, canny gamble of a loud young hi-fi record company, Audio Fidelity, and it wasn't even for sale. The music was faded out every few moments to emphasize its noncommercial nature–but there never was a more fundamentally commercial disc than that one! Nobody had to pay any attention to it, but the stereo disc was launched the day it appeared. Sheer panic.

Instantly there was a rush into frantic competitive development of every phase of the stereo disc. Everybody was sure that his competitors were ahead. Hairs turned gray and formidable problems were solved in fantastically quick time–amid almost unanimous disapproval of the entire development. And yet nobody could stop the thing.

Inevitably, then, as miracles were performed, a certain forced optimism began to appear, which grew more confident with technological success. The panic impulse had been converted into swift action just as instinctively and as powerfully as the most basic fear drive in the anthropologists' annals. I would hesitate to call this a form of panic economics. These constructively intense drives are vital to our economic life. The ugly aspects, the crudities of sales technique, the cynicism of the bandwagon-hopping, the outrageously poor merchandise, the shocking falsehoods and loud vaguenesses of our competitive advertising, are unfortunate but effective. Without them, the panic-push would not have its drive. Without them, the true values would not

have been created in the first place.

What are the advantages of stereo sound and how can one best "convert?"

Good stereo is better heard than described. It is enough to suggest that until stereo, recorded sound has had no more than a single true dimension–that of apparent distance, toward and away from the listener. There is no sidewise sound communication in standard reproduced sound; the "space" is entirely imagined. Given such powerful imaginative resources as we clearly have, it is clear that any process that might add even a token semblance of true side-to-side differentiation should prove to be a major advance in the illusion of reproduced sound. Stereo does just this. Via two sound sources, picked up in different spots by the microphones and fed to your ears from two well-separated loud speakers, a semblance–it is no more–of the genuine separation is added. The ear combines the two sounds into one, filling in the space between the speakers.

Inner texture

Basically, stereo brings a heightened awareness of recorded space to the right and left of the listener. The salesman deliberately falsifies the effect for quick persuasion by playing the right and left speakers with loud contrasts. Much more important, there is, first, a remarkably improved feel of the area within which the sound is heard, the recording hall for example. The music itself, interestingly, takes on the increased realism of its surroundings. Second, there is a much increased clarity of inner texture in music, the result of the spacing-out of instrumental strands of sound over a wide area.

The stereo effectiveness again depends on contact. Banal music makes banal stereo. And it depends, too, on the listener's intelligence and musical awareness. That is a vital ingredient not sold by our stereo dealers!

There are two clearly different ways to convert to stereo, with important economic differences between them. One is to start from scratch, buying complete stereo equipment, including the dual matched speaker systems and dual amplifier equipment. The other is to double up on your existing system, adding a second "channel," coordinated with the first, or adding a subsidiary and less costly extra channel, to save cash. As you may suspect, the first method is much the best and, oddly, the most economical in terms of stereo values.

Note well that the stereo effect itself does *not* depend on the quality of the "fi." It is a phenomenon

that occurs just as easily with two table-radio speakers as in the case of two mammoth hi-fi installations–and the small speakers have the immense advantage of mobility. Sound quality and stereo effect must be clearly kept apart in your mind, whatever the salesmen say–and they really do not know. You may have true stereo in every type of sound from the cheapest portable to a wall-filling "system." Moreover, you may run into dreadful trouble at any level; stereo's problems are democratically widespread.

Things to note

And note, too, these general principles:

• Stereo sound does not cost double for the two required channels. Speaking generally, I would suggest that for equivalent stereo enjoyment–admittedly a subjective thing–you must pay from 20 to 30 per cent more than for non-stereo high fidelity. That percentage will come down steadily as technological progress cuts corners and makes ingenious use of double-purpose circuits and controls.

• Good stereo depends crucially on matched equipment. The two loudspeakers, especially, should sound as nearly alike as possible, and preferably should be identical. That means that you should double your present hi-fi if you want to convert it to stereo; a second and lesser speaker is not a good bet, in spite of numerous ingenious compromises now enthusiastically offered to you. If you can't go all the way, it's best to get rid of your present system and start again.

• The ready-made stereo phonographs have a temporary advantage over the separate-unit high fidelity equipment in that they are factory-integrated, the parts designed to operate together for best effect. The sound of true component hi-fi stereo is better and more economical in terms of values, but there are still major problems that may come up in the matching-together of a stereo hi-fi system. The biggest is "hum." For assorted electrical and magnetic reasons, the chances for that annoying steady tone (a B-natural, musically) are greatly increased in stereo systems and must be much more carefully guarded against. Price is no guarantee–the more elaborate the equipment, the better chance for trouble.

• It is true that stereo equipment and stereo records are more complex, unit by unit, aspect by aspect, than standard mono equipment and records, straight through the entire stereo area. But this must not fool us into thinking that stereo is permanently at a sonic disadvantage, even though trouble in a hundred

ways still plagues most of us who are involved in stereo sound. These problems will be more than solved.

• There are many ways to convert sections of playing equipment to stereo and plenty of "conversion kits" available. Unless you are aware of basic problems involved, they are not generally good buys. "Hum" is the first problem. "Rumble" is a second major problem, since stereo pickups respond to vertical as well as sidewise vibrations. Your old turntable may be fine for standard records and pickup, but it can produce heavy rumble via the new stereo pickup.

Stylus pressure and arm tracking make a third problem. The stereo point is by agreement smaller than the old LP point and requires *much* lighter pressure, although it will play the old records very nicely. Some arms and changers simply cannot be used with the new-type tiny point and ultralight required weight.

Whether stereo is desirable for you, an individual, is less a matter of economics than of listening. Your choice of stereo equipment can follow more or less the standards you have already set yourself for home listening, and the stereo effect will follow along, at the desired economic level. But whether stereo is actually "worth it" for you depends so much on your own subjective feelings that nobody can tell you a thing indirectly–surely not a stereo salesman.

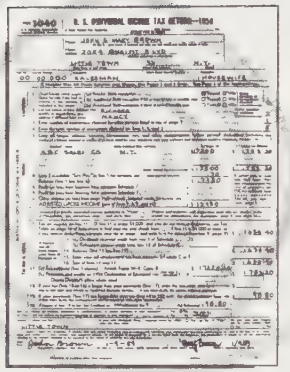
But the chances are you will convert soon. That is the American way. ■

Definition of an Economist

". . .ECONOMISTS are the fortune-tellers of our age, as psychiatrists are the exorcists, and though their claims are extravagant, or the world would not be as it is, they are not quite baseless. It is much more difficult to count than to read or to write, and these are people who can count better than others, and are therefore likely to have a better understanding of those parts of destiny which go by numbers.

"But destiny is very rarely determined by numbers, since man is perpetually deforming his calculations, either because he is too stupid to add and subtract, or because he wants to practice a fraud for his own profit, or because he wants support for some theory learned by the easier art of reading, or because he is suicidal and wants to be ruined. Numbers triumph in the end, for the sum of wronged husbands' assaults on their wives' lovers is a trifle compared to the terrible revenge that two and two wreak on those who pretend that they do not make four. But they take time to effect their vengance, and it is the interim period which defeats the economists' power of prophecy.

–Rebecca West in *A Train of Powder*



A BETTER DESIGN FOR LOOPHOLES

Some tax preferments are a matter of economic wisdom, but our present tax system would be more equitable with smaller holes in the loopholes

by Harry J. Rudick

■ IT HAS BEEN said that the federal tax laws are riddled with loopholes, and so they are. I am not here concerned with tax chicanery or unforeseen methods for escaping the intent of a taxing statute, but only with important loopholes which have been deliberately provided by Congress for the very purpose of permitting certain taxpayers to wriggle through.

Such loopholes are, to give them a more neutral name, essentially tax preferments. It has been estimated that if all the preferential provisions of just the income tax law were repealed and steps taken to prevent noncompliance, the tax rates in all brackets could be cut by at least a quarter.

Justification for the loopholes is made on these grounds: (1) to aid a particular industry; (2) to spur economic activity generally; (3) to avoid hardship; and (4) to avoid complexity, inconvenience or other administrative difficulty. Yet before such preferences are granted, it should be clear that their cost to taxpayers generally will be at least equal to the benefits which flow to the public generally, whether such benefits be in the form of stimulus to the economy or in increased natural resources. The granting of concessions to certain taxpayers must be offset by increased burdens on other taxpayers. It is fair to say that the loss in revenue resulting from tax preferments represents a cost to taxpayers generally.

In practice, it is seldom that a careful, scientific appraisal of the costs and advantages of the preference takes place. More often, the preferment is the result of political maneuvering, lack of understanding and indifference. Yet there are economic realities behind the political pressures.

Consider the favorable treatment accorded capital gains. Suppose a taxpayer bought 100 shares of X stock 10 years ago. He sells it this year at a very large profit. If the profit were subjected to ordinary rates of income tax in the year of sale, much of it would fall into the maw of the tax collector. In that event, our taxpayer would probably not sell the stock at all.

Moreover, if the increment in value had accrued fairly evenly over the period of his holding, it would be inequitable under the steeply graduated rate structure to tax the entire increment in one year. Also, part or conceivably all of the gain may be illusory: the value of the dollar may have declined to such an extent that in terms of purchasing power the cost of the stock was equal to the proceeds of sale. Where this has happened, there has really been no gain, and there should not be any tax. It would be possible by the use of price indexes to eliminate in a rough way the inflationary rise of the stock and exempt that part of the nominal gain. But this would entail administrative difficulty as would spreading the gain out over the years during which the stock was held.

To avoid these problems, to encourage investment and to deter undesirable freezing of investment, Congress has provided a lower rate of tax on so-called long-term capital gains. The preferential rate has applied to various kinds of property–the list of items entitled to the benefit of the favorable rate has grown with the years–provided such property has been held for more than a specified period of time. Today, the gains on the disposition of qualified assets held for more than six months are taxed at the preferential rate, with the maximum tax at 25 per cent of the gain.

If it were not for the limited capital gains rate, the special allowances to the investor in oil, and other preferments for property owners, it is probable that the number of millionaires in this country would have remained static since 1932. It is beneficial to the country to make it possible for smart, industrious and lucky entrepreneurs to become wealthy. I therefore think that the capital gains loophole is worth its cost to the general taxpaying public.

It has been suggested that if the imposition of a limited tax of 25 per cent is beneficial, complete elimination of the tax would be

even more beneficial. It is also said that abolition of the capital gains tax would unloose the dam of static investment, since investors frequently refuse to sell, because of the tax, even when they only have to pay 25 per cent, and this tends to drive up security prices and accentuate inflationary trends.

I cannot agree with these arguments. It seems to me that equity among taxpayers requires some tax on capital gain, particularly when there are so many methods of transmuting ordinary income into capital gain. Capital gain to the extent that it represents true gain is just as spendable as any other type of income, and to exempt it completely would arouse discontent on the part of taxpayers unable to realize capital gain.

Question of time

It is only a question of time before countries which now exempt capital gains completely begin taxing them. As to the argument that the capital gains tax dams up the sale of securities, I think there is some truth to it, but not enough to make it controlling. This is shown by the fact that in countries where capital gains are immune from tax, like England and Canada, the stock markets generally move in the same direction as the securities markets in the United States.

The present system of taxing capital gains is a fair approximation of what is desirable and equitable from the viewpoint of the economy as a whole. However, the present law goes further than necessary in making a six-months' holding period the dividing line between short and long-term capital gains, the former being taxable at the ordinary rates. Furthermore, I think that the classification of the property entitled to capital asset status is far too broad. These loopholes could be better adjusted without affecting the principle of tax preferment for valuable economic activities.

Another important loophole is the immunity from taxation of interest on state and local government bonds, an exemption which costs a considerable amount of revenue. If the exemption were taken away, the borrowing states and their subdivisions would doubtless have to pay a somewhat higher interest rate on their obligations–although probably not in excess of a fraction of a per cent–and this would present a problem, considering the current strain on local government financing. Yet it is difficult to justify the immunity. It creates inequity and increases the over-all burden of government.

Insofar as a loophole favors a particular industry, it is equivalent to a subsidy to that industry. The oil industry is allowed cer-

tain deductions on the theory that they act as a spur to the finding of new oil reserves and thus increase the natural wealth. But whether the tax subsidies produce benefits equivalent to their cost to the taxpayers is another question.

Motivated by sympathy

Permitting a depletion allowance *only to the extent of cost* plus an immediate charge-off of development expenses would constitute more than enough of a subsidy to impel the oil and mining industries to continue their search for new resources. It is not essential to allow these industries to go on taking depletion deductions long after they have fully recovered their entire investment. In no other industry is the taxpayer permitted to deduct more than the cost of his investment. Yet it is a fact that many other industries may be contributing to national resources items as valuable as oil and minerals.

Some loophole preferments do not make any sense at all. An example is the allowance of an additional $600 exemption for persons aged 65 or over, regardless of their income. Congress was presumably motivated by sympathy for elderly people who have difficulty in getting along on small incomes. But, if this is the case, why not make the additional exemption allowable only against the lowest tax bracket of 20 per cent? Certainly the millionaire does not need an additional exemption to make ends meet.

Similar considerations apply to the additional exemption for blind persons regardless of their income. Incidentally, why limit the additional exemption to the blind? Persons with other severe disabilities can, with equal justification, claim that they are entitled to some kind of allowance. The fact is that exemptions of this sort have no proper place in the tax system. Tax laws ought not to be the method of redressing all the unfortunate things that happen to people.

The allowance of the additional exemption for persons who have attained age 65, together with the exemption of a limited amount of retirement income, produces the absurd result that an elderly couple can receive somewhat more than $6,000 of income annually without having to pay any federal income tax. Compare this with the tax burden–approximately $600–which would have to be borne by a young couple with two children receiving an equivalent income. On which couple would the payment of the tax impose a greater hardship?

The fact is that Congress considers its egalitarian tax rates unfair and unwise. We can see this not only in the favorable treat-

ment accorded capital gains generally but also in tax preferences granted to employees. Thus, they may receive part of their compensation at the capital gains rate rather than at ordinary tax rates.

Thus an employee who receives his share of a profit-sharing plan in one lump sum upon severence of employment is taxed on this sum at the capital-gain rate. Moreover, the government, by not currently taxing the income of pension and profit-sharing funds, in effect contributes to these funds.

Business executives can benefit from provisions granting favorable tax treatment to so-called restricted stock options. Employees are permitted to treat as capital gain the profits on the sale of their employer's stock which they have been allowed to buy at a bargain price. This gives them a chance to keep 75 per cent or more of their gain. Had they received the compensation as salary, as much as 91 per cent might have been taxed away. It is not difficult to realize why executives are happy to accept lower salaries, when they get stock options and similar tax concessions.

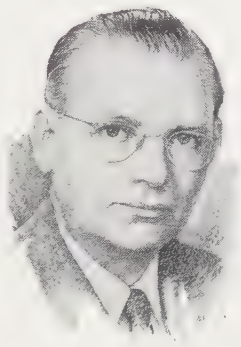
What should we do about the various preferences? I suggest that the best solution would be to eliminate nearly all of them–retaining only those which by general consensus produce over-all benefits of a value greater than their cost. The resulting increase in yield would permit reductions in all rate brackets and make possible a rate structure that would culminate in a top marginal rate of 60 per cent. It would then be unnecessary to have escape valves in order to avoid unconscionable tax burdens and permit significant accumulation of individual funds. The economic value of making it possible for people to become entrepreneurs and engage in new businesses cannot be overemphasized.

The hesitancy of a legislator to support reductions in the higher brackets without at the same time making reductions in the lower brackets is understandable. Yet it *is* possible to make reductions in the lower brackets if we eliminate such costly preferences as double exemptions and the exclusion of sick pay.

Congress should at least carefully and candidly re-examine each preference, deleting those which do not produce general benefits of a value equivalent to the special benefits conferred. This should result in the retention of only truly justifiable preferences. A proper tax policy requires frank and reasoned industry subsidies going no further than necessary to achieve their objective, and mechanisms like the limited tax on capital gains which spur economically beneficial activities. ■

Challenge Profile

Robert B. Anderson— The Nation's Debt Manager



■ MONEY AND TAXES have been historically matters of bitter controversy, a tradition that contemporary events show no inclination to violate. It must therefore be reckoned as one of his primary achievements that Robert B. Anderson, 48, has maintained about himself, as Secretary of the Treasury, a soothing aura of peaceful agreement.

Anderson has not settled the major problems. The essence of his accomplishment lies in organizing working arrangements that permit a functioning of the administrative machine *despite* conflicting opinions held by the key people concerned with money and taxes. Beginning his career as a soft-voiced Texas legislator, Anderson learned early the importance of dealing with men as well as with theory.

With each issue CHALLENGE profiles a person whose thinking affects the pace of the United States economy.

The firm base of his Washington career is the confidence of the President in his policy and capabilities. An Eisenhower Democrat, Anderson was sufficiently impressive as Secretary of the Navy and Deputy Secretary of Defense for Eisenhower to put him on his list of younger men with Presidential potentialities.

Anderson's present job is a good test of those potentialities. One of his major duties is the management of the public debt, which requires the refinancing of more than $70 billion in government obligations annually. This means that Anderson must persuade hard, calculating investors to put their money into bonds and bills instead of the enticing opportunities offered by private industry.

Anderson's sales operations are handicapped by an economic philosophy which he shares with the President. Both are agreed on the

dangers of inflation and the need to use monetary policy to counter it. One of the techniques is raising the discount rates by the Federal Reserve Board. Although Anderson has no authority over the FRB, he helps make the Administration policy that acts as a general guide for it.

Yet the increases were announced after an embarrassing failure of Anderson to refund maturing government debt. He had been hoping to shift the center of gravity of federal debt into longer-term securities, thus reducing the number of times the Treasury must go to the money market to refund maturing securities. Investors, however, prefer not to tie up their money unless they are given a good reason in terms of high interest rates. His last offer did not promise enough returns to attract the buyers.

Anderson's ability to avoid mortal wounding by the dilemma is due to Texas-born and Texas-trained skills that led him swiftly upward from his origins as the son of a small-town retail merchant. He was an Assistant Attorney General of Texas at 27, five years after his entrance into the state legislature.

Anderson did not tarry to enjoy his political prominence; he left government for business, becoming general counsel and, later, general manager of the gigantic W. T. Waggoner estate, a classic Texas domain of a half-million acres of cattle and oil land.

It was natural that Anderson's early enthusiasm for Eisenhower would bring him to Washington. Again, however, he quit government, this time to become president in 1955 of a Canadian firm with oil and mining interests.

His return to government occured in July, 1957, when George Humphrey consummated his desire to leave the Treasury and return to private business. Humphrey was happy to have a successor who would carry on his conservatism, despite the obvious fact that Anderson would not be so tough about it. The President could take comfort that losing Humphrey would not leave him with a hopeless personnel gap.

If Anderson has not produced any overwhelmingly positive achievments, the negative one of keeping out of trouble is almost as much a necessity in politics. He had the prepossession to talk with confidence about the new budget, although he freely conceded, in a statement to the Joint Economic Committee, that "the revenue results for fiscal 1959 will turn out to be substantially less than we originally estimated." They will be less by an estimated $13 billion, but Anderson has the Texas habit of turning magnitudes in his favor.–D.F.

Service industries are growing rapidly, but the country is not getting the kind of services it needs

by Charles E. Lindblom

Bigger but not better

■ TWO CURRENTLY PROMINENT observations about the American economy appear to ride well in tandem. The first is that we are facing an increasingly urgent need for increased production, not of goods but of services: research, education, health and recreational facilities. The second is that the service occupations are continuing to expand as workers move out of manufacturing and agricultural production. If the first poses a problem, the second appears to solve it.

It has been estimated, for example, that by 1970 we shall need four times as many college teachers as we have today to meet the expected increase in enrollment. And although total school expenditures have already increased fourfold since the end of World War II, our concern about the inadequacies of American education in general have never been so acute as now. Similarly, we have become concerned about our needs for basic research.

As a dramatic pay-off on a long march of dimes, the Salk vaccine doubtless opened many eyes to what medical research permits us in terms of aspirations that are nonetheless sensible for being enthralling. The new fast-growing mental health movement is defining needs for psychiatric counseling that dwarf our accomplishments so far. Only a small minority is being helped. If our needs in this area are undefined, they are nevertheless impressive.

Still other public services are being demanded. Both population growth and higher incomes make the demands insistent, and some needs become urgent because of

repeated postponement of public expenditures. The depression of the Thirties, and then the war and the postwar inflation have been excuses or causes for delayed response. A survey by the U.S. Departments of Labor and of Commerce estimates our needs for water and sewage projects, airports, institutional buildings, and similar facilities at $20 billion a year for 10 years, as against the current rate of about $12 billion.

The big shift

The labor shift to services has been going on for many decades. Over the past 50 years, while the proportion of workers in agriculture has declined by about one-half, the white-collar group has doubled. In the same period the proportion of workers in manufacturing has increased only slightly, while those in the service occupations such as entertainment, repairing, the professions, administration, finance and real estate have risen 70 per cent. Automation is expected to continue or accent the same kinds of change.

But now compare the needs for new services with the shifts in the labor force that might supply them. It turns out that what is being supplied is quite different from what our needs call for. One of the fastest growing services to which the shift in the labor force has been recently accommodating itself is television and radio repairing; but our anxieties have been stirred by a lack of quite a different kind of service. And our demands for "public services" like health, education and recreation turn out to be in large part demands for building construction, acquisition of land, equipment and supplies, which are not the product of the service trades at all. The discrepancy is again clear if we set the expanding supply of barbers, brokers, ushers or public utility servicemen against our needs for researchers, teachers, therapists, administrators or construction workers.

The expanding supply of labor in the service trades and occupations is a response to demands, but to demands that are already being expressed in the market. Only to a limited extent, as, for example, in our doubling the supply of Ph.D.'s every decade, are the occupational shifts moving in the direction of need. And even this shift is inadequate to meet anticipated needs.

Yet there is an important indirect connection between shifting occupations and our ability to satisfy still unsatisfied demands. Why did the demand for television repairmen, hotel service workers and hairdressers rise and draw workers into these fields? Not so much because new demands orig-

inally arose, as because the demand for labor declined relatively in manufacturing and agriculture. And it declined in those two fields, not because we wanted to eat less or buy fewer manufactured commodities, but because technological growth made it possible for one man to do what two had done before.

Spending and population

One can imagine circumstances in which rapid gains in productivity could have left men without jobs. But at least two factors forestalled such an outcome. One was an ever-increasing amount of spending because the very gains in productivity that made it possible for one man to do what two had done before permitted the consumer to buy two consumption items where he had bought one before. The other was population growth. In the last 11 years as many people have been added to the American population as were living in America at the outbreak of the Civil War. In short, increased productivity in manufacturing and agriculture has reduced our relative demands for workers in those two fields and has led to greater expansion of the work force in other fields. And the new fields require relatively more workers because of productivity lags. From this fact two inferences point to ways by which we might satisfy our still unsatisfied needs.

The first inference is that continued productivity gains always give us the option of increasing the production of desired services without decreasing the production of anything else. We can have, if we wish, more schools, hospitals, airports or urban redevelopment–or bigger, faster and sleeker autos–without having to give up anything. This is how we got our TV and TV repairmen.

The second inference is that we may have been buying many bad bargains with our increased productivity, for we have taken many of the gains of productivity in the form of personal services in which productivity remains low. The phenomenon of do-it-yourself shows that we are awakening to the fact. Hobbyists aside, the appeal of the movement lies in the discovery that dollars spent on many services give us the benefits of labor not greatly more productive than our own amateurish efforts, and certainly far less productive than the labor we command when we buy manufactured commodities.

Put the two implications together–that productivity gains offer us increased services, if we want them, and that many of our present expenditures are for poor bargains–and we begin to see that a shift in our expenditures to im-

prove presently inadequate services would be easy. We shall go on demanding repairmen even when their productivity is low and their bills excessive–in the hope that they will progress along with the rest of the economy. We do not want to give up serviceable used cars and last year's refrigerators because of minor defects. The new car or appliance is a poor bargain in such a case.

If we can have what we want, how are we to get it? Most of the demands that can be met directly by the market are being met and will continue to be met as these demands grow. *But most of the needs now most urgently felt and publicly debated are those in which the community or nation as a collectivity has a stake*–defense, urban redevelopment and research. These are areas of production where both traditional hostility to government intervention and a dislike for paying a purchase price in the form of taxes have held us back. We are shamefaced that the Russians have successfully made their austerity in collective expenditures contrast oddly with our spending on personal luxury. But even aside from military and scientific rivalry, we begin to see that it is indeed difficult to reconcile crowded double-session schools–taught by an inadequate number of poorly paid teachers–with lavish outlays for a display of horsepower and elegance on the highways.

Tax problems are, however, not to be lightly dismissed. In supporting public activities, the necessity of taxation raises serious problems of equity and sometimes also those of incentives. Hence we can buy our needed collective services wisely only by meticulous attention to the intricacies of the taxing process. Otherwise, almost any new public expenditure is a poor bargain for some important group of taxpayers.

Overlooked opportunities

There may be opportunities for the private sector of the economy that we have overlooked. Certainly a more advanced housing industry might reduce our present reliance on public housing. In the field of recreation, there have been interesting developments of private clubs and associations, as well as profit-making recreational facilities for a fee–all performing what was once believed to be an unavoidable governmental function. Even for public education, it has been proposed that we would do better to give each family a cash allowance for the education of each child, leaving the parent to choose a school as he wishes, thus creating competition among private and public schools, all charging fees. If the idea is usually dismissed as insensitive to

collective interests in the educational process, the fact that it has been suggested at all is evidence, at least, that old formulas for the division of labor between the public and the private sectors of the economy are not to be taken for granted.

The choice is not always either market or government. Toll highways illustrate one combination of government responsibility and price mechanism, and urban redevelopment another. In the latter, government can acquire and clear land and yet leave much of the actual redevelopment to business enterprise responding to market demands. Even within the military, where one might least expect it, new room has been found for market processes, if not always for private enterprise. Where, for example, military transport services could once simply be requisitioned by the military unit in need of them, some of these services are now only available at a price. The possibilities of combining public and private responsibility, as well as of introducing the market into government, open up a wider array of possible policies for meeting our needs than have traditionally been debated.

In deciding what to spend through the market and what to spend through government, we are as a nation not merely deciding the form in which we want to enjoy the fruits of productive growth. Beyond that we are determining future rates of growth, because growth depends on education and research and on the provision of social overheads such as highways, sanitation and urban facilities for commerce. And it will turn out that the expansion of the public sector in some areas such as these is not an alternative but a prerequisite to the expansion of the private sector.

To suggest that for the future we approach our choices with clear eye and head is to challenge the old dogma that government expenditures should normally be regarded as suspect. But the dogma's bark is worse than its bite, for our injuries have been undetectable when we have dared to challenge it. Our purchases through government have already risen since 1913 from 3.5 to 10 per cent of our total purchases. Most of us would not want to give up the defense, housing, highways and schools that we have bought with the increase. ■

An Eye to the Future

OF THE 800 astronomers in the United States, only a few are sufficiently trained in celestial mechanics to aid space agencies in solving orbit problems. Qualified astronomers earn as much as $200 a day as consultants to industries with space research problems.

George Katona
Director
Survey Research Center
University of Michigan

and

Eva Mueller
Program Director

The Consumer Looks at Inflation

Q *There has been a great deal of speculation lately about consumer reaction to secular inflation. Dr. Katona, what do we actually know about the way consumers feel about rising prices?*

K The Survey Research Center here at the University of Michigan has conducted nationwide surveys with representative samples of consumers in order to determine how consumers feel and think about inflation and how they react to inflationary news. Of course, while consumers' attitudes are a very important aspect of inflation, they are not the whole problem. For example, there is also the problem of reactions by large investors as expressed in the Treasury's difficulties in refinancing federal debt. But we shall confine ourselves to what we, at the Survey Research Center, have learned about consumer attitudes and reactions toward inflation.

Q *Dr. Mueller, are consumers expecting prices to go up?*

M Over the past few months there has been a growing feeling among consumers that prices will rise, in spite of our recent experience with relative price stability. Between June, 1958 and early 1959, the percentage of people expecting price advances during the coming year went up from 28 to 61 per cent. Prior to the recession, in 1956 and 1957, about 40 per cent expected prices to go up.

Q *How do you explain this fear of inflation in a period of relative price stability?*

M I think there are two reasons for this reaction: First, there is some disappointment about price trends during the recession. Many people expected that prices would decline with bad times, and they were disappointed when they failed to do this. Secondly, there has been a lot of talk in the newspapers and elsewhere about the threat of inflation, and there is greater public awareness of the problem.

Q *You spoke about short-run expectations. Do the American people believe that we live in an age of inflation, where prices have a tendency to continue rising over a longer period of time?*

M This idea has been gaining ground in the last three years, but it is far from being universally accepted in this country.

Q *Would you say that this feeling–that prices will continue rising–is still confined to a minority of Americans?*

M Yes. At present about one-third of American consumers expect prices to rise over the next five years. This is a substantially larger proportion than five or six years ago, but it is still a minority of consumers. Most people continue to believe that prices will be stable in the long run and that inflation will eventually be arrested.

Q *Well, how do consumers react to expectations of price rises? Do they think it is a bad thing, and if so, do they translate this feeling into action?*

K The American people have some underlying attitudes toward inflation that are very different from attitudes prevailing in other countries, which, incidentally, often contribute to runaway inflation. Runaway inflation is characterized by people rushing to buy. Hoarding, scare-buying, buying in advance and in excess of need are the typical symptoms. Here in America we observe that although people's expectations of higher prices vary from time to time, inflation has always been considered as something bad. In recent years about two-thirds of the people who expected price advances argued that this was "bad," making it difficult for consumers to make ends meet. Wage and salary increases are frequently viewed as consequences of inflation, not as compensation for the damage caused by inflation. However, because inflation is regarded as an unfavorable development, *price increases are resented and do not stimulate buying.*

Q *In what areas of consumer behavior is this negative attitude toward inflation most likely to be translated into fewer sales?*

M Resistance against price increases is most likely to make itself felt in durable goods expenditures. Food and housing expenditures are fairly routine. One may feel very unhappy about paying more for these things. But if the consumer feels that these things cost too much and take more and more away from his budget, this will eventually lead him to cut down on his discretionary spending for house furnishings, cars, appliances, television sets and luxuries. This is where consumer resistance is most likely to make itself felt.

Difficult to establish cause and effect

Q *Has this resistance been reflected in durables sales?*

M The two postwar periods when we had observed strong resentment against rising prices–in 1951 and again in 1957–were both followed by declines in discretionary spending on durable goods. Since it is difficult to establish cause and effect by such historic comparisons, we have also tried to reinterview people in order to see how their spending changed subsequent to the expression of resentment against inflation. We found that people who expect price increases, and who also believe that this is a bad thing, spent 10 to 15 per cent less on durable goods than what would be expected on the basis of their income. This suggests that when many people are inflation-minded, reactions to prices can spell the difference between an expanding durable goods industry and a stagnant or even a slightly declining one.

K It is equally important to note that people who think that prices will remain stable or will even decline slightly are encouraged to spend. Small price declines are not viewed by the masses of American consumers as something bad for business. On the contrary, they are seen as something good for business, because they enable people to spend more and buy more.

Q *How much inflation do you have to have before people notice it?*

K This is a very hard question to answer in specific terms. Generally speaking, we have found that the American people have developed an extremely low threshold to price increases since the end of World

War II. Of course, this does not mean that every price change is really noticed. But, on the whole, even low-income groups and people with little formal education seem to have become increasingly well informed about price trends during the last 10 years.

Q *Do people react differently to inflation when they are buying goods than when they manage their savings or plan their future?*

K This is an extremely important phase of the inflation problem. In other countries runaway inflations have frequently been characterized by flight from money. Bank deposits would be withdrawn and invested in gold, foreign exchange, jewelry and common stock. This has not been our experience in this country. Since 1946 we have repeatedly asked people what they believe to be the wisest use for money not needed to cover expenses. And we have found that for all these years, the majority of consumers has expressed a preference for saving in banks, savings and loan associations, government bonds, and so on–that is, in a form which is not inflationproof.

Q *This is true even of people who expect price inflation?*

K Yes. Although high-income people are increasingly diversifying their savings to counteract inflationary pressures, a surprisingly large number still save only in the form of bank deposits and the like.

Q *Does that mean that people are stupid or uninformed?*

K Of course not. People are very much aware of the fact that the future is uncertain and that savings are necessary. There has been no decline in the *willingness* to save. But many people say that they cannot safeguard themselves against inflation. They have no alternative but to save through banks, savings bonds, etc., because all other means–common stock, real estate and so forth–are too risky and require some expertness. The upshot is that the American people in their saving behavior are not much influenced by inflation. In fact, this imperviousness helps mitigate the impact of inflationary pressures.

Q *What groups are most sensitive to price increases?*

M We have found that there is surprisingly little difference between the way people in different income, occupational or educational groups react to price increases. There is one group, however, about whom we

know relatively little, namely the very wealthy who have a great deal of money to invest.

Q *Dr. Katona, the Survey Research Center is primarily concerned with finding out people's reactions and intentions. How do these reactions and intentions translate themselves into actual buying decisions?*

K We realize that measuring attitudes by asking questions and recording responses is a far from perfect method. If I find that John Smith is very optimistic, this does not necessarily mean that he will be spending an unusually large proportion of his income on discretionary items; he may be a very thrifty person, or have debts to repay. And a pessimistic person may purchase a car to replace one which broke down. But in the *aggregate*, individual peculiarities and errors of measurement cancel out. If our surveys indicate that the American people are on the whole more optimistic today than they were three months ago, then we can conclude that the rate of discretionary spending will increase for the country as a whole.

The process of habituation

Q *Do your surveys indicate that consumers are essentially more optimistic about the future today than they were a year ago?*

K Definitely.

Q *And yet you say that the consumer feels prices are "too high." What leads you to believe that his optimism will overcome his resistance to high prices?*

M We have learned from our past studies that consumers often get used to a price level that they at first considered too high. There is a process of habituation. If prices continue stable for a few more months, and if incomes go up, there is a good chance that price resistance will subside. If the current expansion combines income increases for many more people with some temporary price stability, consumer spending on durable goods will increase. I think it probable that this is what will, in fact, happen.

K On the other hand, let us not forget that the demand for automobiles and consumer durables is still far below the 1957 level. And a

major reason for this slow recovery in consumer durables is popular resistance to prevailing price levels.

Q *You have both stressed the consumer's belief in a stable price level and his confidence in our ability to achieve this. Does this mean that you feel that we have little to fear from a built-in inflationary psychology?*

K It is true that consumer behavior during the past 10 years has helped to mitigate inflation, but that does not mean that consumers will always behave this way. If we have more and more inflationary flurries, and if the American people should become convinced that their government is not concerned over inflation, then a very different psychology may develop. In that case, the basic differences between our slow, gradual inflation and the traditional runaway inflation may disappear. Thus, inflation remains a big danger that must be actively combatted. We must try to have longer periods of price stability between inflationary flurries.

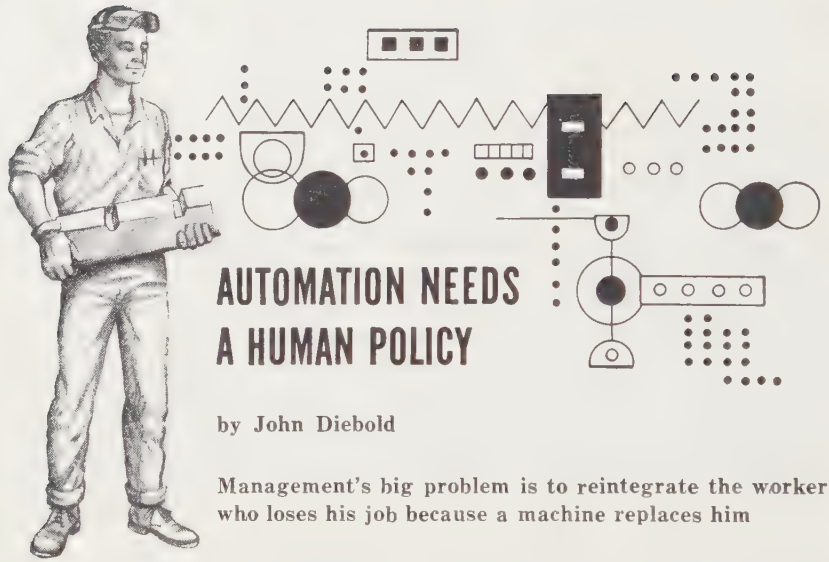
Q *How can a better knowledge of consumer attitudes help government bring this about?*

K I believe that the timing of anti-inflationary measures could be greatly improved by more careful checking of consumer and business sentiment. Psychologically speaking, it is not at all clear that large local and federal government expenditures for defense, schools, highways, and so on, in themselves create inflationary sentiment. Restraining monetary and fiscal policies are most suitable when income increases are frequent and demand is substantial.

Q *But inflation is not the only problem we face.*

K It would be a serious mistake to assume that inflation is the only public enemy. Inflation causes human suffering, but unemployment and recession cause even greater suffering. A government policy to steer the middle way between the two evils of inflation and recession is a very difficult task. It is not an insuperable task, because people's feelings and reactions are no longer shrouded in uncertainty.

Q *Thank you, Dr. Mueller and Dr. Katona.* ■



AUTOMATION NEEDS A HUMAN POLICY

by John Diebold

Management's big problem is to reintegrate the worker who loses his job because a machine replaces him

■ ALMOST EVERYONE AGREES that technological progress is a good thing in the long run. A Congressional subcommittee investigating automation reported that "not a single witness raised a voice in opposition to automation and advancing technology. This was as true of the representatives of organized labor as well as of those who spoke from the side of management."

But the short-run situation and the social problems raised by automation do inspire controversy. Will it lead to mass unemployment? In any case, what will happen to the displaced workers? Will the benefits from increased efficiency be equitably distributed throughout the economy?

The recent recovery from the 1958 downturn has been characterized by an increase in production at a significantly higher rate than that of the increase in employment. Many have pointed to automation as the cause of the disparity in the rates of increase.

At this stage it is very hard to know whether automation can be given the credit–or the blame–for such increases in productivity. It is a characteristic of any organization that after cuts have been made, removing the most inefficient or marginal people and activities, it is possible to increase production or output considerably without a commensurate increase in staff. People work harder and the work is organized so that

fewer people are needed to do it.

In addition, some of the unemployment pockets are caused by decentralization. The automobile industry is more and more moving to decentralized operations outside Detroit, thus reducing the area's employment opportunities.

We have to draw a distinction between mechanization and automation. The first means simply adding machines; the second means *automatic* machines in an integrated setup that eliminates the jobs of many workers. A recession is often a good period to close down an old facility and start building a new plant. Neither the old nor the new need be automated to create productivity increases.

During the recession's 17-month period of declining employment, average hourly earnings rose seven cents per hour. They climbed another seven cents from May to December, 1958, as the recovery took form. Rising wages during a recession period are strong incentives to keep down labor needs. These can be held down through reorganization, better methods, mechanization or automation. At best, automation, even in its crudest form, can take credit for only some productivity increases of the recovery period.

But if automation cannot be made a major villain for recent unemployment, it will continue to grow in importance and increasingly affect the structure of employment. Estimates vary considerably. The minimal prediction says that not more than five per cent of U.S. industry is susceptible to full automation. Moreover, it comes slowly. Even industries that are ripe for automation have to spend a long time planning for its introduction. It may take as long as a generation to overcome the shortage of trained personnel to design, build, man and maintain the machines. And since automation demands capital investment on a very large scale, it will not sweep the economy overnight.

I do not believe that mass unemployment is a likely consequence of automation. But I feel very strongly that it is time to stop arguing about it because all the arguing in the world will not settle the question. Automation cannot be stopped; like the steam engine and the automatic loom, it must be lived with and managed as well as possible. It is time for management to take the lead in a more positive approach. While labor resistance or management resistance can hold back automation's progress, only management is in the position to push ahead.

Management must stop trying to ignore the problem out of existence. It should be clear by now that this approach will not work. Labor is fully alert to the fact of

automation and will not be convinced by statements that it is simply another technological phase that can be relied on to pass without any harmful effects.

A British student of the problem quotes a worker, who was taking part in a strike that seemed to be concerned with automation, as follows: *I know nothing about automation except that my job will go as soon as it comes in. So obviously I've got to fight as hard as I can against any form of it.*

Ideas of this nature in the minds of employees, the British expert points out, "seem to show a complete ignorance of elementary industrial psychology on the part of management. It is what a man thinks that counts. If a man thinks . . . that he will be worse off with the introduction of a new method, that is enough. He will oppose it."

I do not mean to suggest that management, singlehanded and overnight, can calm all fears. Nor do I mean to suggest that only management is at fault. Labor, too, has been guilty of many excesses in the way it discusses automation. But management has done a great deal of harm by trying to sweep the whole thing under the carpet in the apparent hope that it would then not be noticed.

Management must take its employees into its confidence as much as possible. A British labor official has pleaded: "If men have to change their occupations, let them know what steps are contemplated to train and equip them for new occupations; let them know that they are appreciated as human beings and not as so many hands to be hired or fired."

Management decision

Management, of course, cannot consult with its employees about the desirability of automating in the first place. That is clearly and exclusively a management decision. But equally it should not make the mistake of one concern, where management gave no indication of its intentions to automate until the last moment and did not even bother to pass along the good news that the new machines, far from putting men out of work, would in fact demand additional workers. Only after the workers had taken action which, as they thought, would safeguard their interests, did management explain.

Management must concentrate on the real problems. To say that mass unemployment is not a real problem does not mean that no real problems exist in connection with employment. The task is to accomplish the training and particularly the retraining of workers who must learn to tend automatic machines or lose their jobs.

This is a particularly serious problem for the older worker. He is too old to start fresh on his own, even if he can find someone who is willing to hire a man of his age. What is he to do when that job is eliminated by a machine? Industry, labor and the community must join in retraining displaced workers and finding jobs for them.

As far as clerical workers go, there will, in fact, be no serious problem because of the recurrent shortage of clerical help. The steady rise of manufacturing productivity has not been matched in the office, where the number of pieces of paper to be handled increases constantly, to the point of outpacing productivity. For example, approximately eight billion bank checks were written in 1952, approximately nine billion in 1956 and by 1960 the figure will probably be 14 billion.

The major problem, therefore, rests with the semiskilled workers. There are still large blocks of them in such industries as machinery, transportation equipment, food, textiles, electrical equipment, and smaller but substantial numbers of them in some of the smaller industries, such as paper, glass and leather products. We may have to revise drastically our ideas about teaching an old dog new tricks and exactly what tricks he needs to be taught.

Although automated plants require highly trained behavior for some jobs, actual production line work has skill requirements that may be no higher than they are today. "We run that Cleveland plant with people right off the street. It's easier, not harder, work," a Ford plant executive reported. This is a case where individual managements must make a careful study of their needs and balance them against their obligations to their workers and to other aspects of the business.

Effects of change

Another very real problem is the one of workers who are, in fact, displaced by automatic machines. There is no use trying to hide the fact that there will be some of these, for there is no way to guarantee every worker that he will be forever protected against the effects of change If there were, it would be unwise to try to do it. Nonetheless, there is no doubt that automation itself will be responsible for some human tragedy. The problem is a particularly serious one in communities with only one or two industries. A firm might decide, for example, to build a new automatic plant in another location, leaving its old community without sufficient job opportunities to absorb the plant's former labor force.

It should be a regular part of planning for automation to give

consideration to such matters as dismissal pay, training allowances and other measures to cushion the blow to individuals. Management attitudes and performance in these areas will unquestionably do much to mitigate labor resistance to automation.

Another real problem is how the benefits of automation should be divided. This is a problem the whole economy faces, but it must also be decided by the management of each individual firm. Labor's biggest worry, next to mass unemployment, is that it will not get its fair share of the new wealth automation will create. In an automated plant, individual output ceases to have any real meaning, for the machine sets and follows its own pace.

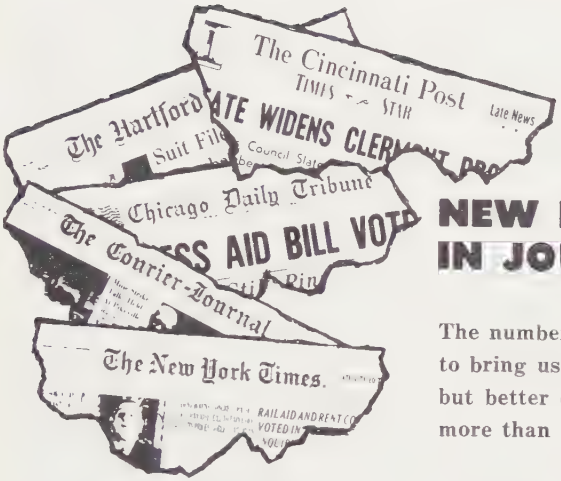
Who gets what?

Should workers who happen to be working for automated industries get the whole benefit of automation? If they do, what effect will this have on workers in industries that are not automated, especially if the industry is not one that lends itself readily to automation? If, on the other hand, such wage increases are granted more or less across the board, wages would outrun productivity increases, and the resulting inflation would harm the whole community.

And what about other claims on the benefits of automation? The consumer, for example, can only gain if prices are lowered. Something must be put aside for further investment, especially since automation equipment is likely to become obsolete sooner than conventional equipment. If wages rise to the limits of the increase in productivity, everything else is shortchanged.

This is only a bare sampling of the kinds of economic problems management must face and solve if automation is to come at the most rapid pace. All change carries with it some risks, and major change is likely to carry with it major risks. Every worthwhile activity has a price, both in terms of certain damage and of potential damage; and the only relevant question is whether the price is worth paying, as the late John von Neumann once wrote. In this case, there is only one possible answer: the price is worth paying.

Labor and management, working together, must show foresight, forbearance, common sense and some degree of mutual trust. Automation, it has been well said, is bound to require a high degree of "social orchestration" in industry. Lip service will not be enough, for it is still true that actions speak louder than words. But if this can be achieved, the price need not be high, and all of society will gain from the new abundance. ■



NEW DIMENSIONS IN JOURNALISM

The number of newspapers competing to bring us news is fast falling, but better quality and coverage more than make up the loss

by **Hillier Krieghbaum**

■ WITHIN FOUR MONTHS during 1958 two of the three major press associations merged, New Orleans newspapers combined under a single management, and Cincinnati's only locally owned newspaper was purchased by the Scripp-Howard group.

When the familiar UP and INS logotypes disappeared with the formation of *United Press International* last May, President Frank H. Bartholomew explained, "Economics was an important factor in the creation of the great new news network." David Stern, publisher of the *New Orleans Item* before it was combined with the *States*, blamed "astronomical operating costs, compounded by the recession."

While this four-month period produced particularly illuminating examples of newspaper economics, it was typical of trends toward fewer daily papers and expanding group ownership. The following also illuminate the mosaic of newspaper economics:

- Stern pointed out that operating costs had risen from approximately $50,000 a week to almost $100,000 during his 10 years with the *Item*. Most publications, daily, weekly and monthly, have a similar cost history.
- Arthur Hays Sulzberger, publisher of *The New York Times*, has said that its revenue from subscriptions and newsstand sales does not even cover the costs of paper and ink. Salaries, cable tolls,

equipment and other expenses all have to be recovered from advertising revenues.

• The cost of newsprint per ton has more than doubled since the end of World War II.

At the start of the 20th century, the printed word was almost the exclusive means for transmitting news to the public. The *New York Journal,* under William Randolph Hearst, and the *New York World,* under Joseph Pulitzer, had each climbed to more than a million copies daily under the whip of competition in yellow journalism terms. Around the country more and more dailies were being started, reaching the total of 2,600 by 1909. But already the choice of dailies the public might read had started to narrow. In 1899, there were approximately 30 dailies for every million persons in the United States. The proportion had fallen to 20 by 1919, when there were 2,078 dailies which had a combined circulation of 26,443,451.

Shrunken choice

The *1959 Year Book* of *Editor and Publisher* now reports 1,751 daily newspapers with an aggregate circulation of 57,418,311. Thus, while the population and circulation figures approximately doubled during the past 40 years, one daily in seven has disappeared. The range of choice in dailies has contracted drastically to 10 per million, or a third of what it had been two generations earlier. Furthermore, 94 per cent of American cities have no local press competition.

While this has been going on, however, a whole new array of competitors entered the arena for news dissemination. In 1920, the first radio newscast announced election results. The Twenties also witnessed the birth of *Time* as a news magazine; soon rivals had entered this field. After World War II television shot up like a bumptious teenager.

The number of radio stations, with 3,180 AM and 537 FM, is nearly double the number of daily newspapers. Television stations have climbed toward the 600 figure, with twice as many expected to be operating within the next five years. The total eventually will surpass the number of daily newspapers. Only one home in 25 does not have a radio set and 50 million television sets are distributed among 84 per cent of all American homes.

Most Americans have repeated and frequent contacts with the mass media. In 1957 the Survey Research Center of the University of Michigan found in a study for the National Assn. of Science Writers and New York University that 49 per cent of the population used all four media–newspapers,

magazines, radio and television.

The monopoly of the daily papers has been broken by competing news media–regardless of whether there are competing papers in a local community. A survey has shown that a majority–57 per cent–of the public still depends on newspapers as its "favorite media" for obtaining general news. However, almost a quarter selected television as its favorite news channel. Radio was picked by 16 per cent and magazines by four per cent. On the basis of these findings, it would make little difference to two-fifths of the public whether it had competing dailies or not; it would be using other media if it had its choice.

Thus, the daily newspapers have encountered strident rivals in telling the news stories. Are they adequate replacements for what has been called the disappearing daily newspaper?

Any contraction in communications media is *potentially* a danger. But there is a lot more to the argument than this.

Critics of the contemporary press too frequently argue–without much evidence to back their suspicions–that the existence of competing dailies insures a healthier, freer situation. That does not follow at all.

Let us assume that two papers in one community are struggling on the verge of bankruptcy for every dollar that an advertiser has to spend or for every favor that a politician has to give. In another locality, one newspaper is economically strong and its publisher and editor are in a position to reject blandishments or pressure. In which of these communities are the readers better served? Obviously, in the one-newspaper town.

An economically secure newspaper is in a position to offer its readers better news coverage. Money may be spent on developing better reporting of foreign news, science developments and business and labor news. The need to meet headline competition in sensational stories does not exist. Of course, much depends on the publisher and editor. Integrity is not guaranteed by newspaper economics.

The real test is in the sense of responsibility felt by the publisher and editor, and not necessarily in the presence or absence of competition. A sense of dedication may be far more rewarding for the public than a competitor's threat.

Strive for objectivity

The honorable editor or publisher will strive for objectivity in covering the news of his community and of the world at large. He will try to interpret the spot developments so that they have

meaning for readers. He will keep the columns, both news and "letters to the editors," open as an arena for public discussion of varying points of view and not restrict them to ideas that he favors. He will try to make sense, rather than try to gain a point on the editorial page. Yet he will not shirk his right to oppose what he thinks is wrong.

On most journalists' lists of the dozen great American newspapers would be the *Courier-Journal* and *Times* of Louisville. These papers are under a single management which has no local competition. But, Barry Bingham and Mark Ethridge believe in their responsibilities to make their papers great.

Critics of the contemporary journalistic scene may protest that this sense of responsibility does not permeate the fraternity of publishers and editors. Possibly, but it is a subjective evaluation. Can news be suppressed in one-newspaper towns? Herbert Brucker, Editor of the *Hartford* (Conn.) *Courant* and former Columbia University professor, answered that question this way:

"The fact is that in one way or another the American public finds out what is going on. If a too conservative press and radio ignore something that is noteworthy, it comes out anyway. Nothing is suppressed for long. Minorities, wise and foolish, public-spirited and selfish, do get their views into the open if only through minority publications."

The Teapot Dome scandal a generation ago and the recent disclosures about Bernard Goldfine and his White House acquaintance, Sherman Adams, illustrate how stories achieve publication.

"Making" news

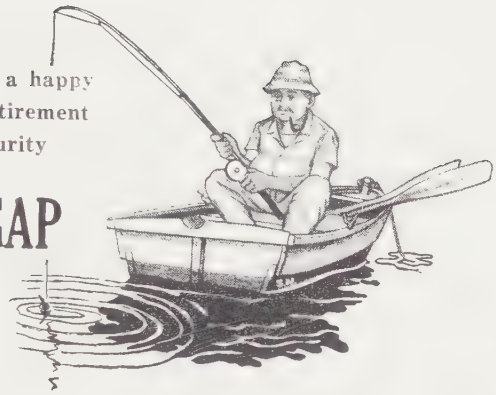
On most occasions, a smart publicist can break through any paper curtain by making news so important or so attractive that even biased editors and publishers, executives and broadcasters must use the news. One labor union representative relates with relish how he got coverage of a strike some years ago by inducing a prominent Philadelphia debutante to join the picket line in her mink coat. He telephoned the society editors of local newspapers, and the strike story first appeared as a social item. After that, it moved over into the regular news columns.

Despite the social pluses and minuses, the millstones of newspaper economics grind inexorably, and there are no discernible signs that the trends of the past half-century will be reversed. Only a population explosion far beyond anything yet witnessed by this country could provide a new market that could support many new newspapers. ■

Pension plus social security is a happy combination, but for many retirement still means only social security

THE PENSION GAP

by Vito Natrella



AT THE END of last year private pension funds held approximately $38 billion of stocks, bonds and other assets. In 1950, only eight years ago, there was less than one-third this amount in these funds. In the last few years, assets of these funds have been increasing at a rate of more than $4 billion per year. What are these funds, and what do they mean to the worker and to the economy? How do they fit into the individual's provision for the future and what do they imply for the financial markets?

Estimates of future growth based on projections of employment and current trends indicate that assets of private pension funds will more than double by 1965. Coverage at that time might amount to more than 21 million persons, or somewhat more than 35 per cent of private nonagricultural employment.

Generally speaking, provision for retirement can come from three sources. These are savings by the individual out of his own income; basic social insurance by the government; and private pension funds set up by the employer or employee groups. Since personal savings in the lower income brackets rarely provided adequate retirement funds, Old Age and Survivors' Insurance was developed to fill the gap. Private pension funds, which had been in existence for some time to a limited extent, then began their sharp rise, contributing a third layer of retirement protection for part of the employee class.

Although covering only a portion of the labor force, savings in the form of pension funds constitute a significant portion of individuals' savings. These funds have in the last few years accounted for more than one quar-

ter of total individuals' savings.

There has been considerable speculation as to the effect of pension funds on saving. Since saving in the form of private pension funds is of an involuntary nature, its net effect will be increased saving, although not to the full extent of the pension increase. At the time of the passage of the Social Security Act, it was contended that thrift would be discouraged and saving diverted from other media. This was not evident from available data, while social security certainly did not deter personal saving.

Significant factor

In addition to the impact on saving, private pension funds have been a significant factor in the capital markets. At the end of 1957, the last year for which we have detailed data, private pension funds, other than those administered by insurance companies, held corporate stocks and bonds valued at more than $16 billion. During the year they purchased $1 billion of stocks, more than any other financial institution or group, and more than one-fourth of the total net purchases by all institutions and individuals. They made net purchases of $1.7 billion of corporate bonds and notes, second in amount only to life insurance companies.

In recent years there has been a tendency for noninsured pension funds to increase their purchases of corporate stocks and bonds as opposed to government securities. In 1950, about 60 per cent of pension fund assets was invested in corporate securities, while one-third was in U.S. government bonds. While the ratio for corporate securities rose to more than 80 per cent in 1957, the government security ratio declined to about 10 per cent. Last year, for the first time in its long history, the pension fund of American Telephone and Telegraph permitted the purchase of common stock. This trend toward equities is likely to continue for some time, and it appears that pension funds will become even more important in the capital markets of the future.

After the establishment of Old Age and Survivors' Insurance, it became clear that only a basic minimum was provided and that private pensions were the means of supplementing the benefits received under the public program. The early plans were frequently set up to provide a certain income level when their payments were added to social security benefits. This system, of course, seemed desirable to the employer, since any increase in old age benefits automatically reduced the portion paid by the private plan. The difficulties and bad psychological effects

in such a procedure became evident as benefits were increased under the federal program. Employees got no benefit increases as the plans reduced their payments. Generally, private plans have chosen to supplement the public program through the use of some formula which passes on some or all of the social security gains to the beneficiaries.

Private savings

In general, the combined pensions under social security and private plans provide adequate benefits. It is also likely that most pensioners under both programs have accumulated some private savings of their own. What of those who receive only social security, in reality only the basic level of old age protection? Of those now covered under social security, less than a third have the supplementary coverage of a private pension plan. While some expansion in coverage is contemplated, there is little likelihood that this ratio will rise above 40 per cent by 1965.

It does not appear likely that much expansion can be achieved without the further development of plans better adapted to small business. Generally, the small or marginal employer finds the future too uncertain to make long-range commitments of this nature. The usual noninsured plan is a large-scale operation and not practical for small companies, while insured plans are too expensive and have minimum coverage provisions under state laws as to number of employees.

There are some plans in use which could contribute significantly to future expansion of coverage. The multiemployer funded plans in certain industries, such as banking and tool-making, have been one solution for the smaller firm. The further extension into other industries under union or trade association sponsorship could build up plans which are economically feasible both as to the spreading of risks and investment experience.

In recent years, trust companies have been successful in developing the common trust fund. Under such a plan, the bank could combine many small funds and obtain the investment advantages of larger funds. While not developed specifically for pension funds, common trust funds have been adapted so that the smaller company can have the benefit of trust company administration at reasonable rates. It does not, however, provide for the spreading of risks where only a few employees are concerned.

There are other plans possible for the small businessman that would take into consideration variation in business activity.

These include deferred profit-sharing plans and terminal funding through regular contributions. These, however, have the disadvantage of being indeterminate, so that the employee does not know the extent of his benefits until retirement.

There is little question that there is some dissatisfaction with retirement arrangements under the present system. The two-thirds of pensioners who have only social security protection are at a disadvantage when compared to the other third which receives additional benefits under private plans. A significant amount of expansion can, of course, be accomplished through the more widespread use of multiemployer plans. The actual extent of this may be limited and will depend on the amount of adaptation that can be devised. The needs are such that new, more flexible, more adaptable plans should be developed to permit broader supplementation of social security.

Pensioners on fixed benefits constitute one of the more severely hit segments of the economy during any sharp inflationary movement. Under such conditions, a pension geared to average earnings during one's working career may have little relation to the cost of living a few years after retirement. It is true that more private plans are shifting to the use of average high salary or final salary as the basis for retirement benefits. Though an improvement, this can still be far from adequate after a series of inflationary pushes. Benefits to retired workers have been raised in recent revisions of the Social Security Act, but these refer only to the basic part of the pensioner's income. There have also been instances of increases to retired workers under private plans. However, these developments have not had too much effect on the problems facing pensioners as a group under severe inflationary conditions.

Two-part benefit

Some headway has been made in meeting the problem of inflation as it affects pensions. Pension plans have been set up under which benefits have been related to the Consumer Price Index. This type of plan is criticized by actuaries on the grounds that costs cannot be forecast.

Another development in recent years has been the establishment of plans in which the benefit payment consists of a fixed part and a variable part. The fixed benefit would be on the same basis as the usual pension while the variable part would be similar to a variable annuity and would fluctuate with the per-unit value of its fund. This fund would be for the most part invested in corpo-

rate equities and to the extent that stock prices parallel the cost of living, the plan would tend to mitigate the effect of inflation on the pensioner. On the other hand, the split feature would dampen wide fluctuations in benefits and provide some measure of stability. We have been seeing increased investments by private pension funds in common stocks. This trend would adapt itself to some of the features of the "variable annuity," thus producing increased benefits in time of inflation.

Another pension effect is the large regular additions to consumer purchasing power created by the payment of benefits, as more and more plans mature. Such steady income could provide some stabilizing effect on the economy in periods of declining business activity.

Private pension funds have shown spectacular growth in recent years and are expected to continue to increase in the near future. Yet most of the recent rise in coverage has taken place in the large companies in the mass production industries. These industries have a high proportion of their employees already covered, so that further expansion is more likely in terms of increased benefits and vesting provisions rather than broader coverage. Industries in which the small business unit prevails or which have a high rate of employee mobility have many problems militating, as we have seen, against any great expansion of coverage under present conditions. Although plans are developed for smaller businesses, the situation would indicate that pension fund growth will be slower after 1965.

The development of pension funds, by its beneficial nature, has more clearly defined the areas of inadequacy. The contrast between those groups which are sufficiently protected and those which are not indicates the direction of future efforts. We can expect that the emphasis on remaining inequities will encourage a more intensive search for solutions to the complex problem of old age security. ■

Answers to Challenge Quiz

(see page 71)

(1) False *(see page 10)*
(2) True *(see page 48)*
(3) False *(see page 20)*
(4) True *(see page 61)*
(5) True *(see page 33)*
(6) False *(see page 13)*
(7) False *(see page 54)*
(8) False *(see page 45)*
(9) False *(see page 29)*
(10) True *(see page 64)*
(11) True *(see page 26)*
(12) False *(see page 37)*

quit claim

Unemployment has been ground down slightly by the accelerating wheels and cams of the general economic recovery. It remained, however, as a problem with a great density of private pain and inconvenience. New claims were down one-third in recent weeks from the level of the same period of a year ago, and a measured optimism was basing itself on projections of this decline. Improvement was slow, as the unemployment figure, placed recently at below 4.4 million, established itself in the character of a lump that would not yield to a few quick swallows.

Detroit model

News of employment rises was accompanied by reports that half of the 149 major labor areas still had "substantial" unemployment, the same ratio recorded a year before. This corroborates the picture of structural trends which have been developing independently of cyclical episodes. The service industries are continuing to grow at the expense of the goods-producing economic sector. Since the great industrial complexes like Detroit are based on the manufacture of hard goods, they have continued to lag behind the rest of the country in employment.

also service

Service industry jobs are up more than 20 per cent from their level of a decade ago. At 32 million, these jobs had gained tremendously in comparison with

manufacturing employment, now at about 26.5 million and down 10 per cent in the 10-year period.

red movement

The discrepancy between the job haves and have-nots will be increased in wage negotiations this year. Patterns of the past are being etched deeper into the economic design. The steel industry is preparing to put the period to its nay-saying with a rise of 10 cents an hour, and other manufacturing industries will curve along with steel. Unless other factors intervene, prices will also make their adjustments according to earthy derivatives of the laws of celestial mechanics. The orbits are getting bigger in our expanding universe.

right revisionism

Business was planning to expand its capital spending only moderately this year. It surprised itself by slashing expenditures during the past recession, and changes may occur as the spring temperature rises toward summer sales gains. Investment was at its previous peak in the third quarter of 1957, when the seasonally adjusted annual rate was $37.8 billion. That rate dropped to $29.6 billion by the summer of last year. Business is expected to increase the present rate of $31.2 to $32 billion in the next few months, holding that level for the rest of the year. But the prophecy is subject to rolling revisions.

fractional distribution

The comparatively modest rises in capital expenditures are reflections of important structural changes. Capacity in manufacturing increased by one-fourth between 1953 and 1957. Yet manufacturing production was up only one-seventh for the same period. The results showed up early in inventory liquidations, and business decided to proceed with an element of caution that had not been written into the first plans. The country has only now emerged from the period of embarrassing plenty, as business inquires how much more investment will be necessary to keep up with technological developments and population trends. ■

IS EQUAL OPPORTUNITY NECESSARY IN EDUCATION?

by Benjamin Fine

Yes, says this expert, who contends that children in the poorer states are being shortchanged

■ LAST YEAR Congress broke through the question of federal aid to education by adopting a bill that provides peripheral benefits to colleges. The National Defense Education Act of 1958 sets aside funds to help colleges provide stronger educational programs for such purposes as establishing language and guidance institutes. A very small number of students will be permitted to borrow money to enable them to go to college. An even smaller number, probably less than a thousand out of the three million who go to college, will be permitted to borrow money for graduate work.

The 1958 Act will whet the appetite of those who believe a strong system of education is essential for the continuance of our democratic way of life. The plain truth is that today the American school system is found wanting. There is no such thing as one school system. Indeed, we have about 50,000 separate and independent school systems.

That is both the strength and the weakness of the American system of education. The poorer school systems, for the most part in rural areas and in the Southern states, cannot afford to spend as much for education as other sections of the country do.

Can federal funds help to equalize educational opportunities? I can see no way of equalizing educational opportunities among the communities and states without federal aid.

A panel of 15 prominent cit-

izens in the Special Education Report for the Rockefeller Brothers' Fund concluded: "All of the problems of the schools lead us back sooner or later to one basic problem–financing. It is a problem with which we cannot afford to cope half-heartedly."

Those who favor federal aid say that without such aid our schools cannot be financed properly. Those who are opposed say that federal aid will inevitably lead to federal control and will lead to economic disaster in the way of inflation. My opinion is: No; we cannot survive without a strong school system, and we cannot have a strong school system without federal aid.

Today there is no equality in American education. Recent studies show that the best financed school systems in this country spend 60 times as much per pupil as those in the poorer areas. The per classroom unit of expenditure ranged from less than $7 to more than $440 per pupil.

Today it is solely or largely a matter of geographical accident of birth as to the type of education our children will receive. A child born in the hills of Arkansas will almost inevitably receive a far inferior education than a child born in the suburbs of Westchester County, N. Y. Even if Mississippi spends 100 per cent of its taxable income for schools, the children there will not get as good an education as the Westchester children.

In his study, *Human Resources: The Wealth of a Nation,* Prof. Eli Ginzberg found that during World War II almost two million out of the 18 million men who were screened were total or borderline illiterates. One practical effect was that we lost the services of millions of otherwise healthy men who could not see service in time of war because they were illiterate.

Can we equalize this inequality through federal funds? My belief is that we can, and that we cannot do it in any other way. The question will be raised: How can this equalization be effected without losing the traditional democratic control over the schools that the public now has?

The noted economist, Beardsley Ruml, has proposed that federal funds be allocated on a per capita, child-in-public-school basis. Since the wealthier states have more children in school, they would get a greater proportion of the money; but Ruml says that this would not affect the principle of equalization. Congress now has before it a bill embodying those principles. Known as the Murray-Metcalf Bill, it specifically assures against federal interference in school control. The states would receive money on the basis of the number of children attending their schools. It would provide

each state with $25 per child the first year, $50 in 1960-1961, $75 in 1961-1962 and $100 from 1962-1963. The costs would start at $1 billion and go to $5 billion a year.

Critics will point out that the larger states like California, Ohio and Pennsylvania will get a much greater proportion of the sum than poorer states like Arkansas and Mississippi. According to the bill's provisions, California would receive $410 million and Arkansas only $44 million in 1962. This does not invalidate the major thesis that federal funds will equalize educational opportunities. The $44 million going to Arkansas will represent a larger proportional increase in the state's educational expenditures than will the greater sum in the case of California.

Arms not enough

Realistically considered, it is doubtful that this bill will be adopted by the present Congress. Even if it were adopted, it would invite a Presidential veto because of the magnitude of new expenditures it envisages. But the American position in the world today requires a comparable approach to our educational problem.

Arms are not enough in our efforts for survival as a nation. Despite the billions spent on defense, we must fight on other fronts than those requiring tanks and nuclear bombs. Our ideological efforts are weakened if they are not firmly based on a democratic way of life, and education is a necessary fortress for freedom.

Five billion dollars a year may sound like a great deal of money. But it is essential that the federal government help to raise the standards found in 50 per cent of the school districts of the United States. As the National Education Association report issued in 1959 puts it: "These depressed school districts now are the seedbeds of millions of migrants who make up a substantial part of the population of the slums of great cities."

Is it desirable to use federal funds to establish a national standard? We are not 50 separate states; we are one nation. If we are to establish ourselves as a strong nation, we must have minimum educational requirements throughout the United States. There is a point where local support and control of education may be superseded by basic federal support.

This is no revolutionary idea. It is certainly in effect in our national road-building program. The roads now are built throughout the United States, and they cut across poor as well as rich cities and states.

However, some will raise the question of how we can justify the use of income of the wealthier

states to help the poorer ones. How do we justify using the income of the richer states to subsidize the national Army, Navy and Air Force used by all the states? The state of New York is rich because the nation itself is strong.

There are valid objections. There may be real inequities involved in forced equalization. Some communities will abuse the principle of equalization. If money is poured into some of the poorer communities, what is to prevent waste? A teacher who now receives $3,000 a year in a rural school in Arkansas or Mississippi, for example, will not be a better teacher necessarily if she receives $6,000. A poor curriculum will not by itself improve if more money is available.

In the long run, the use of these extra funds will improve these school systems. If an area offers better pay, you will get brighter students who will say, "Yes, I want to become a teacher." Also, if the schools have more money to spend, they will seek to raise their own educational standards.

Federal funds needed

Can we afford to spend federal funds for education? Despite the federal deficit, it is essential that the federal government come into the school-support business.

Ninety-six per cent of the cost of public elementary and secondary schools falls on local and state governments. But education's share of all taxes, local, state and federal, is less than it was 50 years ago. In 1922, 20 per cent of all taxes went to education. In 1957, only 12 per cent was allocated to education. Since 1948, local and state debt has gone up 182 per cent, but the federal debt has gone up less than 10 per cent. The federal government has not accepted a reasonable share of the growing school costs.

Economically, it would be sound to support a federal aid program. Those communities, states and nations that spend more of their wealth for education are able to produce even greater wealth. It is clear that the American people do have the necessary economic capacity to support education. Our gross national product has been going up steadily and promises to continue upward.

During the past year, the federal government supported public welfare to the extent of 46 per cent of total costs, highways 12 per cent and education four per cent. It is not a question of our having the money, but do we have the will to support education the way it must be supported in our atomic age?

What are the best methods of presenting the equalization program? Is the Murray-Metcalf Bill

the best method? I believe that at the present time the Murray-Metcalf Bill eliminates as far as humanly possible any federal control. Furthermore, this bill will do the job that we are seeking to accomplish, that is, to equalize educational opportunities. I do know that our school system, nationwide, is growing at a phenomenal rate. In 1947-48, we had approximately 24 million children in our elementary and secondary public schools. Ten years later, this jumped to 33 million, and by 1964-65, we shall break through the 40-million mark.

No matter how much money the federal government may throw into the educational hopper, the ultimate needs must be met from the state and local sources. Even if the Murray-Metcalf Bill is passed, it will provide only an eventual maximum of $100 per pupil, while the present national average per pupil is approximately $300.

In some quarters, the term federal aid is cause for blind anger. In others, it has become an easy answer to all our educational problems. Neither extreme recognizes the reality of the problems.

Federal aid, essential for the survival of the democratic way of life, is a major beginning to the solution of our educational problems. But when we have established that principle, we must go on to the other needs of national wisdom. ■

The Vanishing Hawaiians

HAWAII first applied for statehood in 1903, three years after the islands became a United States Territory. The first Hawaiian statehood bill was vainly introduced in 1921 but 47 more were doomed to failure before Hawaiians could begin drafting their State Constitution. Hawaii is the largest of the 20 islands which make up the Hawaiian archipelago. Only eight of the islands are inhabited. When Captain Cook named them the "Sandwich Islands" in 1778, their population was entirely of Polynesian descent. Today only three per cent of the population is pure "Hawaiian." The new state's population is 38 per cent Japanese, 20 per cent Caucasian, 15 per cent mixed Hawaiian, 13 per cent Filipino, seven per cent Chinese and three per cent Korean and Puerto Rican. War and European diseases reduced the native population from nearly 400,000 in 1778 to 67,000 in 1860. Shortage of native labor for the growing sugar industry led plantation owners to import laborers from China and Japan. By 1900 the Japanese were numerically the most important element in Hawaiian society. The entry of these vast numbers of unmarried foreign laborers led to intermarriage which further reduced the number of pure Hawaiians.

THE PERMANENT FRONTIER

No. 15: the new technology spurs big business mergers in the pre-World War I period

■ THE INDUSTRIALIZATION of the United States between 1860 and World War I meant much more than the accumulation of fixed wealth and capital improvements. The process rudely shook the notion of equality of opportunity that lay at the center of the "American dream." It also upset the assumptions that were the basis of Adam Smith's preindustrial conception of economic reality.

Industrial and financial combination and concentration went hand in hand with industrial development. In 1860 most businesses, except for certain railroads, were still owned by individuals or partnerships. In 1904 John Moody listed 318 industrial "trusts," formed from the consolidation of no less than 5,200 establishments, with a total capitalization of more than $7 billion.

These firms controlled more than 40 per cent of the nation's manufacturing capacity. Seventy-eight of the 92 largest corporations controlled 50 per cent or more of their industries.

Large-scale enterprise became more and more important in each decade after the Civil War. During the 1870s the number of manufacturing firms remained almost constant, but the capital invested in these corporations rose 65 per cent, and the value of their industrial products increased 58 per cent. Between 1850 and 1914, furthermore, the average number of employees per manufacturing establishment trebled, while the average investment of capital in manufacturing firms increased 14 times.

The same process of large-scale growth can be seen in individual industries. Between 1870 and 1890, the number of iron and steel factories fell from 726 to 668, but

the capital invested in the average iron and steel firm rose from $161,000 to $858,000. While 2,076 firms made agricultural implements in 1870, 20 years later only 715 firms were found in that industry. In the meantime, the capital invested in the average firm had increased from $16,780 to $221,751.

Technological innovations

Furthermore, the average number of workers in manufacturing establishments went up. In 1870 the average carpet mill had 56 workers, and the average leather factory had five workers. Twenty years later, the number of employees had risen to 214 and 40 respectively.

Technological innovations gave impetus to the emergence of the larger economic unit. Farseeing entrepreneurs, anxious to gain higher profits from lower unit costs, rationalized production and took advantage of economies of scale. The corporate structure made consolidation more feasible. Mechanization meant much greater costs, but the corporate form made it possible to attract necessary capital. By 1870 most states had general incorporation laws that served the needs of the industrial and financial communities.

From the 1870s, furthermore, nontechnological considerations contributed heavily to the emergence of the larger economic unit and to the appearance of monopoly power. Slowly but steadily, the economics of overhead cost altered traditional attitudes toward the wisdom of price competition and increasingly violated Adam Smith's notion of the "free market place."

The periodically expanding free market encouraged private initiative and enterprise, and the machine itself became a competitive weapon and the "creator" of industrial wealth. Men built new capacity to gain a greater share of the expanding market. "Soon," wrote economic historians Thomas Cochran and William Miller, "there were too many railroads, soon there was too much cotton cloth, or too much salt or flour or packed meat: too much, that is, to yield a profitable return. Free enterprise allowed free expansion in any line and free expansion periodically unbalanced the market."

In such crises, the new high fixed costs–the product in good part of mechanization itself–meant bitter, unrelenting and often "unfair" competition. Driven essentially by a desire for self-preservation, therefore, the in-

This is the fifteenth article of a series in CHALLENGE which deals with the history and development of the United States economy.

dustrialist searched for market power.

Other considerations encouraged intensive and self-defeating price competition. The spread of the national railroad system broke down local "monopolies." A world-wide decline of prices occurred between the mid-1860s and the late 1890s. The inadequacy of the national money supply in these years also added to the deflation and to the cost crisis. Finally, and, perhaps most important, the savage reality of the business cycle, particularly the bitter depressions of the 1870s and the 1890s, exaggerated the entire process and made trouble for the industrial entrepreneur.

Legal and workable

Allan Nevins, the sympathetic biographer of John D. Rockefeller and the Standard Oil Company, puts it this way: "Ever since the Civil War, industrialists had been searching for a mode of interstate combination at once legal and workable. Leaders in various businesses had seen as early as Rockefeller that the savage price-cutting and other practices often incident to unlimited competition must be abated." In the sugar industry, Nevins points out, about 40 refiners, "madly striving to run full time and undersell their rivals," lost so much money that 18 of the firms failed, and "in self-defense" the remaining refiners turned to combination. "Manufacturers everywhere," Nevins concludes, "were searching for an effective means of combination. This was not evidence of wicked greed, as some agitators held; it was evidence of an irresistible business law."

John D. Rockefeller's firm, Standard Oil of Ohio, subdued and reorganized the oil refining industry by efficient economic organization and by ruthless competitive tactics such as rebates and drawbacks. He insisted that combination was "the origin of the whole system of modern economic administration."

"It has revolutionized the way of doing business all over the world," the elder Rockefeller wrote. "The time was ripe for it. It had to come, though what we saw at the moment was the need to save ourselves from wasteful conditions."

At times, informal and nonlegal agreements such as "gentleman's agreements" and "pools" started. The Michigan Salt Pool was a famous regionwide producers' association that restricted output. The meatpackers and the manufacturers of cast-iron pipe and wire nails among others, divided sales territories among themselves.

Informal agreements, however, were not binding when demand fell away, and more "coercive"

methods of restriction were utilized, too. Standard Oil of Ohio pioneered in the use of the "trust," an arrangement whereby competing firms surrendered voting stock to a "board of trustees" that managed the entire operation. Standard soon controlled between 90 and 95 per cent of the refining capacity in the country, and "its success," observed a New York legislative committee in 1888, was "the incentive to the formation of all other trusts or combinations."

Similar organizations started among the cottonseed oil manufacturers and the sugar refiners, among others. A New York judge wrote of the "Sugar Trust": "It can close every refinery at will . . . open others, limit the purchase of raw materials, artificially limit the production of refined sugar, enhance the price to enrich the associates at the public expense, and depress the price when necessary to crush out and impoverish a foolhardy rival."

Another form of business organization that checked ruinous price competition was the holding company. Soon after the passage of the Sherman Anti-Trust Act in 1890, states, in particular New Jersey and Delaware, put through legislation that allowed corporations to own stock in other corporations without receiving special legislative permission. Sizable mergers of great importance, particularly after the depression of 1893-1896, were effected through this technique.

The emergence of the holding company and the depression in the mid-1890s coincided with another significant development that affected the structure of the industrial economy. In these years, the investment banker–the "finance capitalist"–assumed more and more power in the nonfinancial sectors of the economy.

The key link

Best personified by J. Pierpont Morgan and the House of Morgan, the investment banker was the key link between the investor and the industrial entrepreneur. As costs rose and as mechanization progressed, industrialists relied more heavily on the investment banker for funds. Anxious to protect his clients, the investment banker reorganized certain industries and often assumed strategic control of them.

During and after the depression of the 1890s, the rate of investment in capital goods industries slowed up, and the investment banker was able to draw upon unused sources of capital that lay "idle." The merger movement, therefore, had a new impetus. At times, in fact, reorganization served as means for exacting a huge "promoter's profit." More often, however, the investment

banker used his power to bring "stability" to an industry. Just as the industrialist had replaced the farmer in the American icon, the financier, in saving the industrialist from his own excesses, temporarily replaced the industrial entrepreneur.

The debt-ridden railroad system first felt the power of the investment banker. The House of Morgan, and Kuhn, Loeb and Company, who supplied backing for the manipulative genius of E. H. Harriman, overcame the speculative railroad barons. The holding company was the major form of reorganization, and soon after 1900 the House of Morgan controlled the huge shipping "trust," and major rubber and electrical supply corporate structures.

The United States Steel Corporation, founded in 1901, was the first billion-dollar corporation, a holding company of holding companies. The House of Morgan arranged the merger and dominated the final structure, a holding company composed of 800 firms, producing half of the nation's pig iron, coke and steel rails, more than half of the structural steel, and almost all of the barbed wire, wire nails, tin plate and steel tube. When the House of Morgan paid Andrew Carnegie $492 million for his share of the new enterprise, the transfer was symbolic of the triumph of the financier.

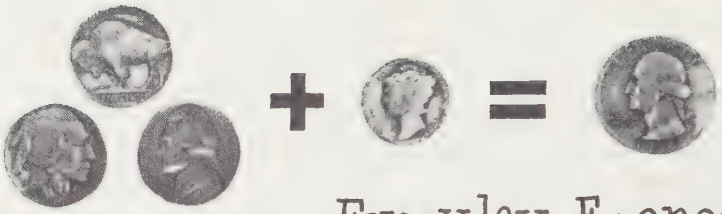
In 1913, when the Pujo Committee issued its famous report on the power of the investment banker, its findings showed that the Harriman-Morgan "group" controlled 341 directorships in 112 corporations in a wide range of industries. Aggregate resources or capitalization came to some $22.245,000,000.

Industry's search for self-protection, therefore, had altered the structure of the economy, reshaped the free market and the 19th century competitive pattern, causing the obsolescence of the models of both Adam Smith and Thomas Jefferson.

"Up to 1870," writes economic historian Ross Robertson, "it had been quite possible for our forbears to live without fear of domination in a *laissez-faire* economy which came near being like the economy that Adam Smith had envisaged–one in which government did no more than to protect from foes without and criminals within and to perform certain essential services . . . ."

While America learned to become indignant about the abuses of the new power, it was also enjoying the new wealth that was the justification and product of the new development. ■

NEXT MONTH: the government begins to regulate big business



Everyday Economics

■ THE CHILDREN of parents who died in war service or because of service-connected injuries or illness are eligible for federal aid in continuing their education. Eligibility ages are 18 to 23. Applications may be filed at any Veterans Administration office by the surviving parent or guardian. The application should indicate a chosen educational plan including a selected goal, schools to be attended and an estimate of total cost. Eligible students may receive up to 36 months of schooling (or the equivalent if enrolled part time.) Full-time students receive $110 a month and half-time students $50 (a student may not enroll for less than half-time work.)

Motoring abroad

U. S. TOURISTS who intended to buy a European automobile during a trip on the continent should arrange for insurance coverage. Most European countries require proof of third-party insurance to be shown at the border. Delivery of international customs documents and driving permit can be arranged with the sales department of the automobile manufacturer. When returning to the States, plan to arrive with an almost empty gasoline tank (the tank is emptied before the vehicle is loaded.) The car must be shipped empty of all luggage and personal belongings, so don't count on filling the trunk with souvenirs.

Water rights

BECAUSE water rights vary from state to state, a new resident or summer landowner should seek legal advice before making non-domestic use of water. In the East most water rights are based on common law or court decisions, *land ownership* being the source of the right. In the West most rights are based on legislative acts, the source of the right being *beneficial use of the water.* As a general rule, the property owner may avail himself of water sources on his property for domestic use

and make a *reasonable* use of it for other purposes. He should know the nature of an underground water source: if it is part of a natural watercourse it is subject to the riparian principle of the equal rights of all owners of land touching on the stream.

School for wives

THE New York Stock Exchange warns that the best made plans for a family's financing security can go to pieces if the wife (who usually inherits most of the fortune and responsibility) is not familiar with them. She should know where to find bank accounts, the safe deposit box, insurance policies, stock certificates and bonds. Her knowledge of *what* the family has and *where* to find it also involves understanding *why*. She should have the answers to such questions as: Was an investment made to provide income? Was it part of a retirement program or was it to pay college expenses?

Accommodations

ACCOMMODATIONS for a summer trip to a national park are best reserved in May. Most parks are closed until the middle of the month, which means that the staff can take no action on reservation requests until that time. By June, however, the most popular parks are already booked for the heavy tourist season. The parks also provide free public campgrounds for which no reservations are necessary. In many parks ranger-naturalists conduct nature walks, auto caravans, lecture on the geology, wildlife and history of the region, and arrange campfire programs.

Machine age

OF INTEREST to June graduates is the Department of Labor's listing of the occupational titles and duties of employees who run electronic data-processing systems. The *project planner* plans and administers the installation of a data processing system, the *systems analyst* devises the broad outline of operation. Then the *programmer* (there may be several) writes the detailed instructions that guide the machine system. The *coding clerk* converts the instructions into coded machine "language." The *console operator* operates the central control unit and keeps records on machine performance. The *data typist* uses a special typewriter to transcribe instructions or data on magnetic tape. The minimum educational requirement is a high school education but most jobs involve college-level training.–S.T.

The Evolution of a Conservative. William Henry Chamberlin. 295 pp. Chicago: Regnery. $4.50.

• The quest for a conservative credo continues. A journalist who has seen many idealistic theories transmuted to the form of killing realities, Chamberlin has learned many useful negatives. The process that changed him from a radical at 20 to a conservative at 60 is a classic one, and Chamberlin cannot escape the banality he fears. His weakness lies in his inability to move forward as well as back. The principles of the Federalists and the insights of Tocqueville are still valuable, but times *have* changed. A contemporary Burke would have more useful reforms to offer than those Chamberlin advocates: a halving of income tax rates, limitations on government powers despite the union and corporate powers which Chamberlin properly deplores, and an unimaginative nationalism. In a world of group clottings, however, it is encouraging to hear Chamberlin's insistence on the value of the individual.

* * *

A Changing America: at Work and Play. A. Wilbert Zelomek. 181 pp. New York: John Wiley. $3.95.

• Caught in the rapid whirl of a changing society, we are still unaccustomed to today when we find ourselves catapulted into tomorrow. The "good old days" are often those we knew only a decade ago–the year 1949 was still a "pre-TV" age. Zelomek studies some of the changes that we find most problematic: automation, culture, the modern woman, leisure, suburbia and the gargantuan growth of the service sector of our economy. Zelomek, a skilled business forecaster, sees the relations and cumulative meanings of seemingly isolated trends and occurences. The result provides some sane views on the enigmatic why, what, and where to. Automation's threat to unskilled and less-educated workers seems less frightening when we observe an already well-established trend toward a better educated working force: there are twice as many high school graduates as there were in 1940. The American woman is not as bent on giving her husband an ulcer in return for a fur coat and winter cruise as she is on reconciling her multiple roles in the economy. Whereas leisure was once synonymous with idleness, the backyard hammock is flanked by a lawnmower. America will continue to change almost overnight. We can remain calm in spite of the whirl, if we use understanding as a nonsoporific tranquilizer. ■

Challenge Quiz

HOW WELL can you do with this true-false quiz? Test your ability to increase your knowledge through reading. Ten correct answers is Excellent; 9, Good; 8, Average. If you do the quiz *before* reading the articles, 6 correct answers is good. Answers on page 55.

(1) Japan's share of international trade is greater than it was in the prewar years.
True ☐ **False** ☐

(2) Over 90 per cent of American daily newspapers have no local competitors.
True ☐ **False** ☐

(3) Manufacturers were optimistic from the first about the future of stereophonic sound.
True ☐ **False** ☐

(4) Education's share of all taxes is less than it was 50 years ago.
True ☐ **False** ☐

(5) In the last 11 years as many people have been added to the American population as were living in America at the time of the Civil War.
True ☐ **False** ☐

(6) Under its aid-to-highways program the federal government will pay half of the construction costs.
True ☐ **False** ☐

(7) Two-thirds of the nation's pensioners receive private retirement benefits in addition to social security protection.
True ☐ **False** ☐

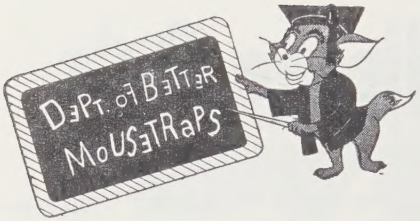
(8) New electronics techniques have reduced the number of checks drawn annually.
True ☐ **False** ☐

(9) Secretary of the Treasury Robert Anderson disagrees with the President on the need to use monetary policy to counter inflation.
True ☐ **False** ☐

(10) By 1870 most states had general incorporation laws.
True ☐ **False** ☐

(11) Capital gains are immune from tax in England and Canada.
True ☐ **False** ☐

(12) Inflationary pressures induce American consumers to increase discretionary spending in anticipation of higher prices.
True ☐ **False** ☐



On the Waterfront: A locking device to prevent outboard motors from being stolen or falling overboard. The device installs on the transom with screws (some of which are hidden to make theft difficult). It fits all motors and automatically centers them. Keys are registered for convenient replacement . . . A paint applicator that facilitates painting the previously inaccessible reaches of a sailboat's centerboard trunk . . . A boat trailer that lowers flat on the lake bed to permit the boat owner to take full advantage of the boat's buoyancy in loading and unloading.

* * *

The Home Workman: *A hand spotlight that plugs into the dashboard lighter well of a car. It has enough cord to reach all parts of the car, a stand for set-up use, a hook for hanging and a plug holder in the handle . . . A spray that prevents the accumulation of grass on lawn mower blades and prolongs sharpness. It can be used on hand, rotary and reel-type mowers . . . Chemicals to make lawn care easy: one kills crabgrass seed and soil insects, another, dandelions, plantain and poison ivy, and a third kills chickweed while leaving lawn grasses unharmed . . . An easily applied vinyl plastic strip that forms a waterproof seal where wall and bathtub meet. It is right-angle shaped and unaffected by cleaning materials.*

From the World of Industry: A stroboscopic device for determining tape speed on electronic data-processing equipment. It tells when tape is off speed and indicates tape slippage . . . A transistor tester capable of checking performance while transistors are connected within their circuits without requiring the power to be turned on . . . A device for pilots that interprets information received from flight control instruments and projects a simulated image of the horizon, the outline of obstacles and the earth.

* * *

Canine Care: *A plastic dog dish that is virtually unbreakable and cannot stain. It is held firmly to one spot on the floor by a rubber suction cup and has a spillproof rim . . . A synthetic dog bone made of nylon has a permanent artificial hambone scent that withstands boiling and scrubbing.*

* * *

Personal Business: Emergency mother of pearl buttons that attach with a safety pin for quick repairs . . . A spray to renew the stiffness of bouffant petticoats; it overcomes the wilting effects of wash and weather . . . For the short housewife who is afraid of ladders, an extension arm like those used by grocers to help reach items stored on high shelves.

* * *

Children's Corner: *For the curious school-age child, a series of toy collections that come with an illustrated booklet explaining the scientific principle behind the toys and suggesting additional experiments the child may perform to learn more.*

* * *

Write to CHALLENGE magazine for additional information. ■